

HELENA, MONTANA 59620

# FROM LIQUOR STORES TO BURLINGTON NORTHERN RAILROAD: ISSUES BEFORE THE REVENUE OVERSIGHT COMMITTEE

A Report to the 50th Legislature

December 1986

PLEASE RETURN



*Montana Legislative Council*

Published by  
**MONTANA LEGISLATIVE COUNCIL**  
Room 138  
State Capitol  
Helena, Montana 59620  
(406) 444-3064

**MONTANA STATE LIBRARY**

S328.3 L13ref 1986

From liquor stores to Burlington Northern



3 0864 00059149 8

3-18-88  
JAN 20 1989  
REVENUE OVERSIGHT COMMITTEE

**FROM LIQUOR STORES TO BURLINGTON NORTHERN RAILROAD:  
ISSUES BEFORE THE REVENUE OVERSIGHT COMMITTEE**

**A REPORT TO THE 50TH LEGISLATURE**

December 1986

Published by  
**MONTANA LEGISLATIVE COUNCIL**

Room 138, State Capitol

Helena, Montana 59620

(406) 444-3064



## MEMBERSHIP

### REVENUE OVERSIGHT COMMITTEE

|                                                 |                                                |
|-------------------------------------------------|------------------------------------------------|
| Senator Robert J. (Bob) Brown,<br>Vice-Chairman | Representative J. Melvin Williams,<br>Chairman |
| Senator Bruce D. Crippen                        | Representative Gerry Devlin                    |
| Senator Thomas O. Hager                         | Representative John G. Harp                    |
| Senator Joseph P. Mazurek                       | Representative Dan W. Harrington               |
| Senator William J. (Bill) Norman                | Representative Nancy A. Keenan                 |
| Senator Thomas E. Towe                          | Representative Jack Ramirez                    |

### MONTANA LEGISLATIVE COUNCIL

Senator Allen C. Kolstad, Chairman

Diana S. Dowling, Executive Director

Robert B. Person, Director,  
Division of Research and Reference Services

### Committee Staff

|            |              |
|------------|--------------|
| Researcher | Dave Bohyer  |
| Attorney   | Jim Lear     |
| Secretary  | Jeanne Johns |



### Publisher's Note

This report was published in August of 1987, several months after the legislative session to which it was addressed. There are, consequently, included in the narrative references to legislation considered during the 50th Legislative Session that resulted from activities of the Revenue Oversight Committee during the 1985-86 interim.

Additionally, credits shown in this report are for persons associated with the Revenue Oversight Committee, the Legislative Council and elsewhere during the 1985-86 interim.



## TABLE OF CONTENTS

|                                                                                                                                 | <u>Page</u> |
|---------------------------------------------------------------------------------------------------------------------------------|-------------|
| PREFACE . . . . .                                                                                                               | 1           |
| PART ONE: . . . . .                                                                                                             | 3           |
| CHAPTER ONE: A Reexamination of Railroad and Utility Valuation<br>and Options for Complying with Federal Legislation . . . . .  | 3           |
| Introduction . . . . .                                                                                                          | 3           |
| Requirements Under Section 306 of the 4-R Act . . . . .                                                                         | 4           |
| Valuation of Utility and Railroad Property . . . . .                                                                            | 5           |
| Cost Approach . . . . .                                                                                                         | 7           |
| Rate Base Cost Approach vs. Market Value Cost Approach . . . . .                                                                | 8           |
| Income Approach . . . . .                                                                                                       | 9           |
| Stock and Debt Approach . . . . .                                                                                               | 11          |
| Correlation of Valuation Approaches . . . . .                                                                                   | 12          |
| Allocation of Value . . . . .                                                                                                   | 12          |
| Preliminary Recap . . . . .                                                                                                     | 13          |
| Property Assessment in Montana . . . . .                                                                                        | 14          |
| Assurances of Equitable Assessment . . . . .                                                                                    | 14          |
| Options for Meeting the Requirements of the 4-R Act . . . . .                                                                   | 15          |
| Summary . . . . .                                                                                                               | 16          |
| CHAPTER TWO: Burlington Northern Railroad Property Taxation: A<br>Comparison Among Eighteen States . . . . .                    | 19          |
| Survey Results . . . . .                                                                                                        | 21          |
| Summary . . . . .                                                                                                               | 36          |
| Selected References . . . . .                                                                                                   | 37          |
| Appendix A: Survey Questionnaire Sent to States Having<br>Burlington Northern Railroad Operating Property . . . . .             | 39          |
| Appendix B: Burlington Northern Tax Data From 18 States . . . . .                                                               | 43          |
| Appendix C: Footnotes for All Tables Contained in Parts One<br>and Two and in Appendix B . . . . .                              | 61          |
| CHAPTER THREE: Revising Options for Determining the Tax Rate<br>Applicable to Burlington Northern Railroad's Property . . . . . | 65          |
| Background . . . . .                                                                                                            | 67          |
| As a Basis for Discussion . . . . .                                                                                             | 69          |
| Under the Governor's Proposal . . . . .                                                                                         | 70          |

|                                                                |     |
|----------------------------------------------------------------|-----|
| Summary and Conclusion . . . . .                               | 84  |
| Epilog . . . . .                                               | 88  |
| PART TWO . . . . .                                             | 93  |
| Introduction . . . . .                                         | 93  |
| CHAPTER FOUR: Issues Relating to Montana's Liquor              |     |
| Enterprise . . . . .                                           | 95  |
| Early Deliberations . . . . .                                  | 95  |
| Addressing the Issue: ROC Subcommittee on Liquor Recovery. . . | 104 |
| May 1986 . . . . .                                             | 107 |
| June, and the Third Special Session . . . . .                  | 110 |
| PART THREE . . . . .                                           | 117 |
| CHAPTER FIVE; Bill No. 701: In-kind Payment of Inheritance     |     |
| Taxes . . . . .                                                | 117 |
| Introduction . . . . .                                         | 117 |
| The Bill . . . . .                                             | 118 |
| The Daly Mansion . . . . .                                     | 119 |
| The Moss Mansion . . . . .                                     | 120 |
| Summary . . . . .                                              | 122 |
| PART FOUR: Miscellaneous Issues Before the Revenue Oversight   |     |
| Committee . . . . .                                            | 123 |
| CHAPTER SIX: Montana's Tax Incentive for the Production of     |     |
| Alcohol: Problems Experienced by Montana Producers . . . .     | 123 |
| Legislative History of Alcohol Production Incentives . . . . . | 123 |
| Administration of Incentive Payments . . . . .                 | 125 |
| Summary of History and Legal Requirements . . . . .            | 127 |
| The Issue Before the Committee . . . . .                       | 127 |
| Comments from Montana's Alcohol Producers . . . . .            | 129 |
| Establishing the Scope of the Problems . . . . .               | 129 |
| Summary and Conclusion . . . . .                               | 131 |
| Epilog - Committee Action . . . . .                            | 132 |
| CHAPTER SEVEN: Vehicle Fees and the Revenue Oversight          |     |
| Committee . . . . .                                            | 135 |
| Introduction . . . . .                                         | 135 |
| Options Proposed . . . . .                                     | 136 |
| Committee Discussion . . . . .                                 | 136 |
| Summary . . . . .                                              | 138 |

CHAPTER EIGHT: Summary of the Activities of the Revenue

|                                               |     |
|-----------------------------------------------|-----|
| Oversight Committee 1985-86 Interim . . . . . | 141 |
| Other Issues . . . . .                        | 143 |

roctofc2



## PREFACE

The 1985-86 interim followed a session where the participants were unquestionably philosophically divided on many matters of taxation. Issues of income taxes, minerals taxes, the coal severance tax, and perhaps preeminent, property taxes, led to long floor debates and vehement disagreement between the political parties.

In some measure, the tenor of the final days of the regular session carried over to the early meetings of the Revenue Oversight Committee. Several issues were assigned to the Committee; e.g., SJR 14 and HB 704. Several others were left to the discretion of the Committee.

After lengthy (and in some measure, heated) discussion, the Committee was willing to undertake the issues assigned to it for study. The members were not willing, however, to address other issues without being persuaded by necessity. Several motions to undertake studies of the state's income tax, property tax system, and a sales tax failed on tie votes. Other study issues were dismissed for lack of a motion. At one point during the Committee's June 7, 1985, meeting, the meeting at which the interim's work schedule was outlined, the Committee's frustration was evidenced by a statement made by Senator Joe Mazurek:

My sense is that this Committee would rather do nothing than do anything. I think we have an obligation [to undertake studies of important tax issues] because we all know that we're going to have money problems next session. We have an obligation to look at alternatives for raising revenue, by income tax, by sales tax, or other options that I think this Committee has to look at so that we don't come into the session cold.... It would behoove us to have some public discussion before the session so that we have some options and know the impact of the different alternatives. We know it will be very partisan, but we should look into [the issues of alternative sources of revenue].

Consequently, the Committee early on discontentedly pursued a schedule that focused on the study assigned to it in Senate Joint Resolution No. 14 and met its responsibilities under House Bill No. 701. Later in the interim, however, the Committee was persuaded to undertake other issues of critical importance: property taxation, state and federal income tax reform, and the sales tax issue.

The following narrative looks at the major issues addressed by the Revenue Oversight Committee during the 1985-86 interim. Part One looks at the taxation of the Burlington Northern Railroad's operating property. This issue has been before the Revenue Oversight Committee for at least the past 6 years. It appears that the issue has not yet been resolved.

Part Two examines the state's liquor enterprise. Declining liquor sales, following a national trend, and the consequent decline in liquor profits compelled the Committee to review a Department of Revenue plan to save the system.

Part Three reviews the Committee's role in reviewing the option of "in-kind payment" of estate and inheritance taxes. House Bill No. 701 adopted by the 49th Legislature, provided for the "trial balloon" of allowing estate and inheritance taxes to be paid through the in-kind transfer of certain unique property.

Part Four addresses several other issues that required the attention of the Revenue Oversight Committee, including the state's subsidy for the production of ethanol, the rationale for calling the first special session, and a look at developing and executing a comprehensive study of Montana's tax system.

Each of the Parts in this report is written to stand on its own. Therefore, a reader with a specific interest need only refer to the subject of choice rather than sift through the bulk of the report.

Any questions related to the material contained in the report may be directed by mail to the Montana Legislative Council, State Capitol, Room 138, Helena, Montana, 59620, or by telephone at (406) 444-3064.

PART ONE  
CHAPTER ONE

**A Reexamination of Railroad and Utility Valuation  
and Options for Complying with  
Federal Legislation**

**INTRODUCTION**

During the 1983-84 interim, the Revenue Oversight Committee engaged in an extensive study of the implications of the Railroad Revitalization and Regulatory Reform Act of 1986. The outcome of that study was a Committee recommendation in the form of Senate Bill No. 48 of the 49th Legislature. House Bill No. 240 was a back-up recommendation and, as the legislative process would have it, became the principal legislative vehicle for railroad transportation property tax reform.

Since the Railroad Revitalization and Regulatory Reform Act (4-R Act) was passed by Congress in 1976, states' options in taxing railroad transportation property have been restricted considerably.<sup>1</sup> The provisions of the 4-R Act are restrictive in that any state or local assessment or tax rate that is higher for railroad transportation property than the assessment or tax rate for all other commercial and industrial property in the same tax jurisdiction as the railroad property is prohibited. Consequently, states are required to bring their respective tax systems relative to railroads into compliance with the 4-R Act.

The issue addressed here is the identification of options for achieving the required compliance, not only for railroad transportation property, but for all property protected by federal law. The issues are addressed by reviewing the requirements of the 4-R Act, examining how "value" for tax purposes is established under the unit method of appraisal, and, finally, examining how Montana's property tax system and the 4-R Act have been reconciled.

---

<sup>1</sup> The same is true of other types of transportation property, including airlines and motor carriers. Since the provisions of federal law prohibiting tax discrimination by states is essentially the same for all three types of transportation property, references to tax implications to railroad transportation property are similar to the other types of transportation property as well. For convenience, the three types of property are "lumped" into one category, which is often referred to in this report as "federally protected property" or "protected property".

## Requirements Under Section 306 of the 4-R Act

The language of the 4-R Act most relevant to this discussion is contained in Section 306 of the Act. In part, the provisions of Section 306 state:

(1) Notwithstanding the provisions of section 202(b), any action described in this subsection is declared to constitute an unreasonable and unjust discrimination against, and an undue burden on, interstate commerce. It is unlawful for a State, a political subdivision of a State, or a governmental entity or person acting on behalf of such State or subdivision to commit any of the following prohibited acts:

(a) The assessment (but only to the extent of any portion based on excessive values as hereinafter described), for purposes of a property tax levied by any taxing district, of transportation property at a value which bears a higher ratio to the true market value of such transportation property than the ratio which the assessed value of all other commercial and industrial property in the same assessment jurisdiction bears to the true market value of all such other commercial and industrial property.

(b) The levy or collection of any tax on an assessment which is unlawful under subdivision (a).

(c) The levy or collection of any ad valorem property tax on transportation property at a tax rate higher than the tax rate generally applicable to commercial and industrial property in the same assessment jurisdiction.

(d) The imposition of any other tax which results in discriminatory treatment of a common carrier by railroad subject to this part.

In order for states to comply with these provisions, each state must determine:

- 1) the true market value of railroad transportation property;
- 2) the level of assessment for railroad transportation property;
- 3) the true market value of all other commercial and industrial property;
- 4) the level of assessment for all other commercial and industrial property;
- 5) the ratio of the assessed value of railroad transportation property to the true market value of the property;

- 6) the ratio of the assessed value of all other commercial and industrial property to the true market value of all other commercial and industrial property;
- 7) the tax rate applicable to railroad transportation property; and
- 8) the tax rate applicable to all other commercial and industrial property.

Once the above data are compiled, each state, assuming the state is the responsible taxing jurisdiction, must ensure that the value described in item 5 does not exceed the value described in item 6 and that the item 7 rate does not exceed the item 8 rate. If the item 5 value exceeds the item 6 value or the item 7 rate exceeds the item 8 rate, the state is in violation of the 4-R Act.

Under this formula, the state's responsibility is fairly well clarified. The state must accurately measure the true market value of all commercial and industrial property, including railroads, and subsequently determine at what percentage of true market value such property is assessed. However, a real problem may arise in some instances in determining the "true market value".

#### **Valuation of Utility and Railroad Property**

Disagreements arise from many quarters as to the true market value of railroad property, principally because of the fact that railroads as separate entities do not change ownership very frequently. For this reason, a commonly accepted and easily understood method of appraisal based on comparable sales is not available. Consequently, estimates of true market value using other more technical methods must be made.

There are several methods of valuing railroad property, as well as other types of industrial and utility property. However, none of the methods has universal acceptance by all interested parties. While somewhat lengthy, the following quotation from a report by the Western Association of Tax Administrators (WATA) is quite instructive.

Prior to discussing the several approaches to value (cost, income, and stock and debt), a few comments are appropriate on market value and on unit valuations. In the laws of most, if not all, states, there is a

definition of value for property tax purposes. The descriptive words may be full cash value, actual cash value, true cash value, fair cash value, or market value. Without involving ourselves in the niceties of words, it is assumed that all of these values contemplate a value equivalent to a transaction where a willing buyer and a willing seller exist, where both parties are knowledgeable, where there is no undue pressure or force to buy or sell, where reasonable time exists for exposure of the properties to the market and where negotiations are at arm's-length.

The natural comment from the critic or the intent student of central assessment is that since the properties sell so infrequently, there is never established a market value bench mark. This is true and it is also true of certain properties other than railroads and utilities. The mere fact that sales are lacking does not preclude the appraiser from attempting to estimate a value at the defined market value level. It becomes a real challenge to those in central assessment appraisals to find a theoretical market value. Because there are no sales, does not lead an appraiser to a salvage or scrap value concept. These would be appropriate only when salvage or scrapping was imminent. It does not mean valuing the properties under a different use unless a new use is in the offing. It does mean an estimate of a market value which a purchaser would pay contemplating a similar use of the property as of assessment date.

Closely akin to market value is the use of the unit appraisal technique. The unit appraisal means valuing the total properties as "one thing." In contrast, the summation appraisal is valuing individual items as fractional items and then adding together the value of all the fractions to reach the total. Centrally assessed properties are usually thoroughly integrated in operation and construction. The value of a length of copper wire in an electric system lies not in the fact that copper has a market as scrap metal but that the wire is a part of a thoroughly complete and integrated electric system. An item in the complex array of many property items practically defies individual or segregated valuation. Segments of the total property can be valued by allocation or apportionment of the total unit value when required for statutory reasons even though allocation violates the basic theory of unit valuation. As the usual rule, however, no attempt is made to assign values in a unit appraisal to individual items of property unless it is a legal requirement. Standing apart, individual items of property possess some type of liquidation value; arranged together as a team of properties, the total property complex has a value invariably greater than the sum of many liquidation values for individual items. (WATA, pp. 2-3.)

What is stated above, then, is that railroad property, like other utility property, is most reasonably valued for tax purposes as a unit and not as it might be broken into its separate parts. In addition, a reasonable approximation of true market value can be ascertained by any of several methods, even without numerous market sales for verification.

The three most commonly used methods for valuing railroad property are the cost approach, the income approach, and the stock and debt approach. Unquestionably, each method has its strengths and weaknesses as well as its supporters and detractors.

### **Cost Approach**

The cost approach to market value suggests that the cost of the property, depreciated, will approximate the market value of the property. While the theory of the cost approach may be economically sound, there are several items deserving attention when using this approach.

The first of these items is the proper "cost" to assign to a property being valued. There are basically five types of cost indicators:

- 1) historical -- cost when first put in service;
- 2) original -- the cost of a property to the present owner;
- 3) book value -- the original cost less accrued depreciation;
- 4) reproduction -- present cost to replicate the property; and
- 5) replacement -- present cost to replace the property with a functional equivalent.

There are cases in which there is no difference between the various costs. With new property, for example, original cost and book value are the same, and are likely indicative of market value. However, circumstances are rare that an entire property would have equal original cost and book value due to the effects of depreciation on the property over time. Hence, the cost of the property must be devalued to allow for depreciation.

Depreciation itself deserves some attention because of its effect on a property's value: i.e., reduction in value over time. Depreciation is represented by three different factors resulting in reduced value.

The first of these factors is physical deterioration, generally a result of the normal aging process, including action of the elements.

The second factor is functional obsolescence. This type of depreciation is a loss in value because of functional deficiencies or inadequacies within the property itself. Technological changes are often the cause of functional obsolescence.

The third factor is economic obsolescence. This type of depreciation results in a loss in value caused by factors outside the property itself. Regulation of earnings and the base upon which earnings are founded are often cited as examples of economic obsolescence.

Regardless of the method of depreciation used in valuing property under the cost approach, each of the depreciation factors must be accounted for.

#### **Rate Base Cost Approach vs. Market Value Cost Approach**

Because utility property commonly has as its rate base the book value, appraisers often hear the argument that the same book value is market value for tax purposes. This argument is addressed directly in the Western Association of Tax Administrators (WATA) report on railroad and utility valuation.

By coincidence book value and market value may be the same but basically they are different in theory. Rate base is a statistic, not a valuation, let alone a market valuation. If rate base were adopted as market value, it would be unmoved by inflation and depression, by adverse earnings, by varying costs of money and the whole market environment. Secondly, rate base is a reference point or datum plane to measure performance. For illustration, if earnings are allowed at a certain level, it is not determined always by a percent times a rate base. In most cases a level of earnings is allowed and when that is related to a common denominator there results a ratio known as a rate of return. A rate base may be a very convenient reference point where if all conditions meet a certain standard, the base is value. Conditions that are usually encountered do not possess ideal characteristics; hence the appraiser must apply measurements of market attitudes to estimate market value. Thirdly, items includable in a rate base are not always taxable items; hence qualitatively they may be distinctly different. (WATA, p.6)

As indicated by this statement, book value for rate purposes is rarely the same as market value for tax purposes. Even though railroads do not face the same rate regulation as many other utilities, it would logically follow that book value would rarely equal market value for railroad property. Some additional conclusions of WATA regarding the cost approach are worth noting.

In the case of regulated property where the rate base is keyed to historical or original cost, reference was made not to a reliance on book depreciation for measurement of loss in value but more strongly to earnings performance and the market attitude to that performance. Finally, in the discussion of reproduction and replacement costs, those costs are appropriate only when measured by prudence. The prudent investor examines the market and concludes that a certain investment in a certain field will return to him certain benefits (earnings) in preference to other alternate investments. So it can be analyzed that the cost approach can be used if all the legitimate adjustments to costs (new) are made to result in an estimate of market value. No doubt, authors have sensed this or analyzed it similarly, that energies are wasted in seeking the correct cost approach and then theorizing all the adjustments that the given approach must have. They probably conclude to go to the earnings approach which has all the peculiarities and individual characteristics submerged in its three variables; namely, quantity of income, duration of stream of income, and the discount rate. As stated earlier, these three variables pose problems of their own.... If a cost figure can be adjusted realistically to reflect an approximate market value, it could be used in conjunction with other indicators of value to provide relative stability to a formulaic result. (Western Association, p. 7)

### Income Approach

The income approach to estimating market value is based on the premise that the current value of an income-producing property is represented by the discounted total future earnings of the property. This approach can be illustrated algebraically:

$$V = \frac{I}{r}$$

Where: V is the current value;  
I is the income; and  
r is the discount or capitalization rate.

The algebraic simplicity of the formula belies its complexity. While it is evident that value is wholly dependent on income (I) and the capitalization rate (r), it is much more difficult to determine precisely what "income" is, and also, what figure should be used as the capitalization rate.

At least two problems arise when dealing with the income variable. The first is which type of income to use: gross operating revenue; gross operating revenue less operating expenses; gross operating revenue less operating expenses and depreciation; gross operating revenue less operating expenses, depreciation, and federal income tax; net income; etc. The second problem, assuming a certain level of income is considered appropriate, is establishing the total future income. Because the actual future earnings of a property cannot be known until they are historical facts, some estimate must be made of the future earnings. This is typically done through an examination of past earnings and recent and future additions to income-producing plant.

Given the assumptions, estimates, projections, and so on that must be made with respect to income, it is easy to speculate on potential disagreements between the taxpayer's estimate of income and value and the appraiser's.

The second variable in the value formula, the capitalization rate ( $r$ ), generates at least as much controversy as the income variable. Although there are undoubtedly many reasons behind the controversies, none is more evident than the fact that a seemingly minimal change in the capitalization rate results in a considerable difference in current value and, hence, in taxes paid.

Even given the difficulties in establishing values to "plug-in" to the income approach formula, the approach itself has widespread support as a surrogate for market value. At a recent seminar on the appraisal of utility and railroad property, three noted experts commented on the approach's strengths.

A properly computed income approach is the most reliable of the three measures of value. [T]he income approach goes to the very essence of value for income-producing property, and measures value without the qualifications inherent in the cost and the stock and debt approaches.

Clarence M. Brasfield  
Division Staff Manager-Taxes  
Southern Bell, Atlanta, Georgia

In terms of flexibility and adaptation to specific appraisal conditions, the income approach ranks first. Complex appraisal problems may be resolved through use of the income approach when the appraiser utilizes knowledge and skill appropriately. More conventional appraisal problems may be addressed with relative ease. The market value standard can be achieved

in either case through careful adherence to the principles of the income approach.

Seth L. Franzman  
Arizona Department of Revenue

In the valuation of railroad and utility property, I would rank the income approach above the cost approach and generally on a par, or above, the market data approach when estimating value. The income approach can be applied to all types of property that is purchased with the expectation of monetary profit. If the income is properly estimated, that is as change in net wealth over time, and is properly discounted, that is adjusted for risk and time, the indication of value is consistent with the action of investors in the marketplace.

Arlo Woolery, Executive Director  
Lincoln Institute of Land Policy

The foregoing statements lend considerable support to the income approach as the best single approach to estimating market value. However, each of the experts would also consider the other two approaches to valuation. This leads to an examination of the third approach, stock and debt.

#### **Stock and Debt Approach**

The stock and debt approach to valuation is based on the estimates of value relied on in the nation's financial markets. The formula for the stock and debt approach is taken from the most basic of accounting equations, Assets equals Liabilities plus Capital. Since the information being sought is the value of the taxable assets, the information can be quantified by valuing the liabilities and capital, and then subtracting the value of all nontaxable assets.

Like the other two approaches, the apparent simplicity of the stock and debt approach camouflages its complexities. Determining a value for common stock, preferred stock, long-term debt, and liabilities is the lesser and simpler of the tasks required in this approach. The larger and more difficult task is the determination of nonoperating assets, i.e., assets not subject to tax, to be subtracted from the total asset value.

The real strength of this approach lies in the premise that the financial markets' indicators of value, i.e., stocks and bonds, accurately reflect the market value of the property. Whether or not the premise is valid is another issue, even

recognizing that the judiciary has accepted this method since the mid-nineteenth century. (Thompson, p. 80.)

Arlo Woolery, former Executive Director of the Lincoln Institute of Land Policy, contends that the principal weakness in the stock and debt approach is the same as in the other approaches.

[The weakness lies] not in the approach or the theory that underlies the approach, but rather in our deficiencies as appraisers. Our limited ability to process and understand the large amount of market data lies behind our inability to achieve defensible market values by any of the three indicators. (The Income Approach, pp. 10-11.)

### **Correlation of Valuation Approaches**

Because each of the approaches to valuation has identifiable strengths and weaknesses, most appraisers rely on all three when estimating value. The "weight" given to the values resulting from each of the approaches is commonly referred to as the "correlation" of the approaches. This correlation is largely affected by the confidence an appraiser has in any of the approaches (in any given appraisal).

Many experts would advise against simply averaging the values indicated by the three approaches or predetermining any other weighting scheme. The Montana Department of Revenue, for example, while not working under a statutorily imposed weighting scheme, had an agreement with the Burlington Northern Railroad that the weighting (through 1985) would be 10% for the value indicated by the cost approach, 50% for the income approach value, and 40% for the stock and debt indicator. There is no specific weighting scheme required for tax years after 1985.

### **Allocation of Value**

Once the value of the utility or railroad as an operating unit has been finally determined, a second determination must be made as to what portion of the unit's value is attributable to the particular taxing jurisdiction. This process is called "allocation".

There are many factors that can affect the allocation of value. Robert McSwain, a recognized expert in utility appraisal, in a recent presentation on railroad and utility valuation, categorized the factors into three types: property factors, income factors, and use factors. (McSwain and Shank, pp. 29-30.)

Property factors, according to McSwain, are the most reliable, the most available, and the most widely used for allocation of utility property. In the special case of railroads, property factors are combined with income and use factors for allocation. For railroads, property factors would include the value of property (as indicated by cost) and track miles. (McSwain and Shank, p. 29.)

Income factors, consisting of some measure of revenue, are unreliable, difficult to measure, and difficult to audit or support. Use factors, too, with the exception of airlines and railroads, are very difficult to measure. The use factors for railroads include measures such as car miles, locomotive miles, car days, and ton miles.

Finally, whatever set of factors is used in the allocation of the unit's value, the appraiser must ensure that the factors reasonably reflect the value allocable to the taxing jurisdiction. Invalid allocation factors can only lead to importation or exportation of real value, a situation that must be avoided to assure an accurate valuation.

### **Preliminary Recap**

With respect to taxation, there is no single element in the tax equation more important than valuation. Valuation is the factor upon which all other tax variables depend.

Of the three approaches to valuation of utility and railroad property -- cost, income, and stock and debt -- none is universally accepted by appraisal experts as the one best approach. While the income approach currently enjoys the most support, professional appraisers advocate that value be estimated using all three, each having strengths which serve as checks to the other approaches. Consequently, a correlation of the three values results in the best indication of market value of the entire unit.

Once a defensible unit value is calculated for the property, factors reflecting the value of the property allocable to the relevant taxing jurisdiction must be selected. Considerable attention should be given to selecting the allocation factors to ensure that the allocated value is an accurate representation of the value of the property within the jurisdiction.

### **Property Assessment in Montana**

Montana statutes require that all taxable property "must be assessed at 100% of its market value". (15-8-111, MCA.) As in all states, Montana considers market value as the value of the property assuming an arm's-length transaction between a willing buyer and a willing seller, both with reasonable knowledge of all relevant facts. In addition, all property must be revalued at least once every 5 years. (15-7-111, MCA.) The purpose of these provisions is to ensure that all property is valued fully and equitably.

For most types of property, the system provided in Montana statutes works reasonably well. However, due to federal legislation, some types of property are assured protection from state-imposed tax discrimination. Property granted this protection includes railroad transportation property, airlines, and some property involved in interstate trucking.

The protection involves, for the most part, assurances that federally protected property is not taxed in a discriminatory manner, and perhaps because the first element required to calculate property taxes is the property's value, the federal legislation is keyed toward ensuring equity in assessment.

### **Assurances of Equitable Assessment**

As previously mentioned, the provisions of federal law requiring nondiscriminatory tax treatment of railroad transportation property are found in Section 306 of the Railroad Revitalization and Regulatory Reform Act of 1976 (4-R Act). Air carrier property is guaranteed the same treatment under the Tax Equity and Fiscal Responsibility Act of 1982 as is motor carrier (trucking) property under the Motor Carrier Act of 1980. Under similar legislation, H.R. 3500, the Omnibus Budget Reconciliation Act of 1985, interstate pipeline property would have received (had it

passed) the same protection. Although the wording in each of the Acts varies, the effects of it do not. - As stated in the 4-R Act, there is a proscription against any

. . . assessment (but only to the extent of any portion based on excessive values as hereinafter described), for purposes of a property tax levied by any taxing district, of transportation property at a value which bears a higher ratio to the true market value of such transportation property than the ratio which the assessed value of all other commercial and industrial property in the same assessment jurisdiction bears to the true market value of all such other commercial and industrial property.

This federal mandate requires states to establish the true market value for all commercial and industrial property, including federally protected property and, subsequently, to determine at what percentage of true market value commercial and industrial property and protected property are assessed. The final federal requirement is that the level of assessment and taxation is no higher for protected property than that applicable to other types of commercial and industrial property.

#### **Options for Meeting the Requirements of the 4-R Act**

During the 1983-1984 legislative interim, a Montana Revenue Oversight Committee in-depth examination revealed that options available to the state regarding the 4-R Act and other federal legislation aimed at aiding the transportation industry were severely limited; in fact, it appeared that there were only three basic options.

The first option was to exempt federally protected property. This could have affected state revenues collected under fixed mill levies and created a potential shifting of tax burden where levies are flexible.

The second option was to effectively create a two-class system -- a class subject to federal legislative policy and a class subject to state legislative policy. This included authorizing the administrative adjustment of both the assessment level and the tax rate of federally protected property to that of all other commercial and industrial property.

The third option was to statutorily further restructure Montana's property tax classification system into two categories of property -- commercial and industrial, and all other taxable property. It was this option, with some adjustments, that

provided the foundation for legislation recommended by the Revenue Oversight Committee and ultimately considered by the 49th Legislature.

During the 1985 legislative session, House Bill No. 240 was adopted, a variation of the third option including some elements of the second option as well. Under this system, Montana maintained much of its historic classification system. An annual sales/assessment ratio study of all commercial and industrial property will have to be done, with the results applied to federally protected property to assure compliance with federal law.

If any of the options are to be studied further and eventually developed into legislation, the Legislature would, in some fashion, be required to once again address the following issues:

1. Some redefinition of what constitutes commercial and industrial property will have to be made. This does not necessarily require a redefinition of property classes, but could instead be accomplished through the assignment of property to either the commercial and industrial category, or to the category of property other than commercial and industrial.
2. Some method of obtaining reliable information with which to compare valuations will have to be developed or, if available, maintained. This could include the implementation of an annual assessment/sales ratio study of a statistically significant sample of commercial/industrial property sales as required by HB 240.
3. A policy decision could be considered as to whether different tax categories should be developed for real and personal property within the broad classes of commercial and industrial and noncommercial/industrial. If the decision is in favor of different categories for realty and personalty, further definitions will be necessary.
4. Some estimate of the effects of the Legislature's policy decision(s) should be made in order to give notice to local governments of changes in taxable value and the resultant changes in tax revenues from federally protected property.

## **Summary**

Under the 4-R Act and similar federal legislation regarding other protected transportation property, states' options in taxing the protected property are limited. Each of the federal acts is aimed at eliminating discriminatory treatment of the

protected property in matters of property taxation. The purpose of the acts is clearly that of equalization.

Montana's 49th Legislature revised the state's property tax system in an effort to achieve federally mandated equalization. Disregarding the politics of the Legislature's policy decision manifested in House Bill No. 240, the substance of the bill promotes if not ensures nondiscriminatory treatment of federally protected property. As the state's policy is now set and has been implemented, the only remaining questions lie in the survivability of the policy in jurisdictions outside the 49th Legislature acting in regular session.

Litigation in federal district court, filed by the Burlington Northern Railroad in 1986, has yet to be decided. The outcome of that litigation should provide an indication of the legality of Montana's interpretation of the 4-R Act. However, there is considerable speculation that the opinion rendered by the federal district judge, either upholding or overturning Montana's law, will be appealed.



## **CHAPTER TWO**

### **Burlington Northern Railroad Property Taxation: A Comparison Among Eighteen States**

#### **INTRODUCTION**

The data contained in this part of the report was prompted by a November 1985 request by the Montana legislative Revenue Oversight Committee (ROC) to examine how other states treat railroad operating property for property tax purposes. The request resulted, in part, from an announcement by Burlington Northern, Inc., (BN) that a BN diesel locomotive repair shop located in Livingston, Montana, would be closed in 1986.

The decision by BN followed action taken by the 49th Legislature acting in regular session that brought Montana's property tax system into compliance with the federal Railroad Revitalization and Regulatory Reform Act of 1976 -- commonly referred to as the "4-R Act". The legislature's action was the adoption of House Bill No. 240 (Ch. 743, L. 1985).

House Bill 240, among other things, provided that federally protected property, e.g., railroads and airlines, would be declared a separate class of property for property tax purposes. The tax rate applicable to this class of property was established as a function of two elements: (1) the tax rates applicable to all other commercial and industrial property; and (2) the level of assessment (compared to market value) of all other commercial and industrial property. Consequently, the formula provided in HB 240 guaranteed federally protected property nondiscriminatory treatment under Montana's property tax system, bringing Montana into compliance with the federal 4-R Act.

#### **Scope of the Survey**

Following the November 15, 1986, meeting of the ROC, a questionnaire was sent to the legislative research offices in 23 states having BN railroad operating property. Data for BN's property in Montana was compiled from resources in the Montana Legislative Council offices and the Montana Department of Revenue (DOR).

The questionnaire was comprised of eight basic questions and provided space for specific descriptions and explanatory notes. A copy of the questionnaire is contained in Appendix A.

Of the 23 states surveyed, six did not respond:<sup>2</sup> Alabama, California, Iowa, Mississippi, Missouri, and Tennessee.

States responding to the questionnaire included:

|           |              |
|-----------|--------------|
| Arkansas  | Nebraska     |
| Colorado  | New Mexico   |
| Florida   | North Dakota |
| Idaho     | Oregon       |
| Illinois  | South Dakota |
| Kansas    | Texas        |
| Kentucky  | Washington   |
| Minnesota | Wisconsin    |
| Montana   | Wyoming      |

#### Limitations of the Data

As is usually the case with general survey data such as this, the information received has its limitations. For example, the base year for all states but Arkansas, Oregon, and Texas is 1985; for those three states the base year is 1984, making the data between those states and others not completely comparable.

Another example, one perhaps more important, is the tax rate applicable to railroad property. The limitation here is that while most states require valuation to be at "true market value", i.e., an assessment ratio of 100%, states that have classified property tax systems (and some that don't) establish certain levels of assessment less than 100%. In some instances these assessment levels parallel Montana's tax rates; in other instances there is an assessment rate and a tax rate.

Most of the information provided in the following tables and narrative is generally valid for comparison. An effort has been made to note where comparison is probably not valid.

---

<sup>2</sup> In the cover letter accompanying the questionnaire, a December 11, 1985, return date was requested. No responses were received after December 15, 1985.

It will be important to remember that all of the footnotes listed in the tables are included as Appendix C.

## **SURVEY RESULTS**

### **Method of Valuation**

During the ROC examination of railroad taxation during the 1983-84 interim, it was reported that virtually every state uses the "unitary method" for valuing railroad operating property. This was substantiated in some measure by a survey of 13 western states taken by Legislative Council staff during August and September of 1984.<sup>3</sup> That survey indicated that all 13 states used the unitary method for railroad valuation.

This survey's responses show similar results: all 18 states responding indicate use of the unitary method for valuing railroads. Combining the results of the 1984 survey with this newly acquired data shows that at least 21 states use the unitary method for valuing railroad property. None of the states responding to either of the surveys indicated using any method for valuing railroads other than the unitary method.

### **Personal Property**

In Montana most personal property is taxable, although it is classified in several classes and at varying taxable rates. The same is true in many if not most other states.

Because the 4-R Act requires that railroad property be treated the same as other types of commercial and industrial property, the personal property of railroads must be treated the same as other commercial and industrial personal property. Therefore, personal property exempted for commercial and industrial property owners must also be exempted for railroads.

---

<sup>3</sup> Montana Legislative Council, "Montana's Property Tax and the 4-R Act and Other Revenue Oversight Issues", Montana Legislative Council, December, 1984, Table 3, pp. 3-12.

In North Dakota, for example, personal property -- except for railroads' -- was exempt from property taxation for commercial and industrial property owners prior to 1980. Because of this exemption, court rulings upheld the railroads' contention that railroads' personal property should also be exempt. Consequently, for 1985 approximately 50% of BN's unit value was considered personal property and therefore exempt from property taxation in North Dakota.

The survey responses indicate that 14 states subject personal property to property taxation. (The 1984 survey mentioned previously shows an additional three states taxing personalty.) Only 4 states of the 18 states responding exempt personal property, including that owned by railroads:

Illinois  
Minnesota  
North Dakota  
South Dakota

#### **Burlington Northern Unit Value**

Unfortunately, of the states responding to the survey, four states -- Florida, Kentucky, Oregon, and South Dakota -- did not provide their calculated unit value of BN's property. However, since virtually every state uses the unitary method to value railroad property, a comparison of the responding states' valuations of BN's property provides some interesting information.

As shown in Table 1, Wyoming calculated the value of BN's property at only \$2.447 billion, or slightly more than 55% of Washington's value for BN of \$4.434 billion.

#### **Burlington Northern's Allocated Value**

Before a state can begin to determine the tax payable by a railroad valued by the unitary method, the state must "allocate" a portion of the railroad's unitary value to the state. This allocation process typically involves the weighting of several factors to determine what portion of the railroad's total value belongs to the respective state.

TABLE 1

Burlington Northern Railroad Unit Value  
State Ranking By Unit Value

| State           | BN Unit<br>Value<br>(Billions) |
|-----------------|--------------------------------|
| =====           | =====                          |
| 1 Washington    | 4.434                          |
| 2 Idaho         | 4.398                          |
| 3 Montana       | 3.462                          |
| 4 Kansas        | 3.200                          |
| 5 North Dakota  | 3.094 aa                       |
| 6 Arkansas      | 3.000                          |
| 7 Texas         | 3.000                          |
| 8 Wisconsin     | 3.000                          |
| 9 Colorado      | 2.999                          |
| 10 New Mexico   | 2.974                          |
| 11 Nebraska     | 2.900                          |
| 12 Illinois     | 2.800                          |
| 13 Minnesota    | 2.764                          |
| 14 Wyoming      | 2.447 √v                       |
| 15 Florida      | NA                             |
| 16 Kentucky     | NA                             |
| 17 Oregon       | NA ii                          |
| 18 South Dakota | NA                             |

Factors considered in allocating value usually consist of such things as total value of property in the state, payroll in the state, ton miles of freight transported in the state, miles of track, and so on. What is important here is not so much which factors are used, or how they are weighted in determining the allocated value, but rather a recognition that whatever factors or weighting schemes are used must result in an accurate allocation of value to the state.

Using appropriate factors and weighting results in an accurate allocation of the unitary value and precludes the importation or exportation of value.

TABLE 2  
Burlington Northern Railroad Allocated Value  
State Ranking by Allocated Value

| State           | BN Value<br>In State<br>(Millions) |    |
|-----------------|------------------------------------|----|
| =====           |                                    |    |
| 1 Montana       | 489.191                            | r  |
| 2 Nebraska      | 447.500                            |    |
| 3 Washington    | 396.800                            |    |
| 4 Wyoming       | 256.909                            |    |
| 5 North Dakota  | 246.306                            | bb |
| 6 Minnesota     | 232.100                            | k  |
| 7 Texas         | 156.000                            |    |
| 8 Oregon        | 97.108                             | jj |
| 9 Illinois      | 95.600                             |    |
| 10 Colorado     | 93.859                             |    |
| 11 Wisconsin    | 81.951                             |    |
| 12 Idaho        | 61.119                             |    |
| 13 Kansas       | 49.110                             |    |
| 14 Arkansas     | 29.700                             |    |
| 15 New Mexico   | 25.636                             |    |
| 16 Florida      | 2.760                              |    |
| 17 Kentucky     | 0.125                              |    |
| 18 South Dakota | NA                                 |    |

#### Burlington Northern's Taxable Value

Once a state has determined what portion of the unitary value should be allocated to the state, it can begin to adjust the allocated value to arrive at the value against which levies will be assessed. For convenience, this value is referred to here as the "taxable value".

In Montana, all property is to be appraised for tax purposes at true market value. (Stated differently, the appraised value of property is statutorily required to be at a 100% ratio of the amount at which the property is assessed compared to the amount it would sell for in a competitive market.) This is called the "assessed value" or "appraised value".

Because Montana has a classified property tax system, each class of property has a "taxable rate" factor at which the assessed value of the property is taxable. For example, in 1985 Class four property (real property) was taxable at 8.55% of its assessed value, agricultural land at 30% of its assessed value, and railroad property at 15% of its assessed value.

All states use some method to arrive at a taxable value for property subject to taxation, and virtually every state requires that property initially be assessed at 100% of market value. From this 100% standard, methods vary as to how states arrive at a taxable value for property. Some simply use 100% of the assessed value as the taxable value; others first apply an "assessment ratio", much like Montana's taxable rate; and others apply both an assessment ratio and a taxable rate. Consequently, the amount of value subjected to levies varies a great deal, especially when related to a specific state's calculated unit value and taxable value.

**TABLE 3**  
**Burlington Northern Railroad Taxable Value**  
**State Ranking by Taxable Value**

| <b>State</b>    | <b>BN Taxable<br/>in State<br/>(Millions)</b> |    |
|-----------------|-----------------------------------------------|----|
| =====           |                                               |    |
| 1 Washington    | 371.899                                       |    |
| 2 Nebraska      | 362.200                                       | v  |
| 3 Texas         | 156.000                                       | nn |
| 4 Minnesota     | 122.300                                       | l  |
| 5 Oregon        | 97.108                                        |    |
| 6 Colorado      | 92.857                                        | b  |
| 7 Wisconsin     | 81.951                                        |    |
| 8 Idaho         | 61.119                                        |    |
| 9 Montana       | 35.368                                        | s  |
| 10 Illinois     | 31.900                                        |    |
| 11 Wyoming      | 26.975                                        |    |
| 12 Kansas       | 9.655                                         |    |
| 13 North Dakota | 8.500                                         | cc |
| 14 New Mexico   | 4.086                                         |    |
| 15 Florida      | 2.346                                         |    |
| 16 Kentucky     | 0.125                                         |    |
| 17 Arkansas     | NA                                            | a  |
| 18 South Dakota | NA                                            |    |

For example, Tables 1, 2, and 3 show Washington with a \$4.434 billion unit value for BN, \$489.2 million allocated value for BN, and \$371.9 million in taxable value for BN. Comparatively, the same tables show Texas with a \$3.0 billion unit value for BN, \$156.0 million allocated value for BN, and \$156.0 million in taxable value for BN.

#### Tax Rates Applicable to Railroad Property

As mentioned in the taxable valuation section, the manner by which states arrive at taxable value varies considerably. Some states simply use the level of assessment as the taxable rate; others (like Montana) have a separate taxable rate; and others, both an assessment rate and a taxable rate. Therefore, caution should be exercised in making comparisons between states on their respective taxable rates applicable to railroads.

TABLE 4  
Tax Rates Applicable to Railroad Property  
Alphabetical by State

| State        | Tax<br>Rate<br>(Percent) |    |
|--------------|--------------------------|----|
| Arkansas     | NA                       | a  |
| Colorado     | 14.000                   |    |
| Florida      | NA                       | d  |
| Idaho        | 100.000                  |    |
| Illinois     | 33 1/3                   |    |
| Kansas       | 19.660                   | h  |
| Kentucky     | 100.000                  |    |
| Minnesota    | 43.000                   | m  |
| Montana      | 15.000                   |    |
| Nebraska     | 80.000                   | w  |
| New Mexico   | 33 1/3                   | z  |
| North Dakota | 10.000                   | dd |
| Oregon       | 100.000                  |    |
| South Dakota | NA                       | ll |
| Texas        | 100.000                  |    |
| Washington   | 93.700                   | qq |
| Wisconsin    | 100.000                  |    |
| Wyoming      | 10.500                   |    |

# 1985 Property Tax Paid by Burlington Northern

The bottom line for every taxpayer is the amount of tax paid. For property taxes, the amount paid is a function of the taxable value of the property and mill levies assessed against the value. Table 5 lists the amount of property tax paid by Burlington Northern in the 12 states reporting.

TABLE 5  
1985 Property Tax Paid By Burlington Northern  
State Ranking by Amount Paid

| State           | Property<br>Tax Paid<br>(Millions) |
|-----------------|------------------------------------|
| =====           | =====                              |
| 1 Nebraska      | 10.300                             |
| 2 Montana       | 8.535                              |
| 3 Minnesota     | 5.300 n                            |
| 4 Washington    | 3.583 rr                           |
| 5 Wisconsin     | 1.846                              |
| 6 Wyoming       | 1.819                              |
| 7 North Dakota  | 1.486                              |
| 8 Kansas        | 1.254 i                            |
| 9 Oregon        | 1.118                              |
| 10 New Mexico   | 0.080                              |
| 11 Florida      | 0.037                              |
| 12 Kentucky     | 0.001                              |
| 13 Arkansas     | NA                                 |
| 14 Colorado     | NA                                 |
| 15 Idaho        | NA                                 |
| 16 Illinois     | NA                                 |
| 17 South Dakota | NA                                 |
| 18 Texas        | NA                                 |

It is important to remember that each state has a variable tax mixture in its overall tax system. This mixture, for railroads, might include not only property taxes but license taxes, franchise taxes, use taxes (e.g., ton-mile tax), sales taxes, income taxes, and others. Therefore, a comparison between states of the amount of property tax paid by BN is only that: a comparison of property taxes. It cannot

be extended as a general comparison of the overall tax burden on BN between states.

### **Valuation Issues and Appeals**

Perhaps because valuation is the starting point in the tax calculation formula, and as such arguably the most important, many issues revolve around valuation formulas, equalization, and discrimination.

Of the 18 states responding to the survey question on valuation appeals, 12 indicated that BN railroad has appealed its valuation since the effective date of the 4-R Act. Idaho, Illinois, Kentucky, New Mexico, and Texas reported that BN has not appealed its valuation under the 4-R Act. Oregon did not respond to the question, although it did return the survey questionnaire.

Outlined below is a brief summary of the issues appealed in the various states.

**Colorado** -- The issues were: (1) equalization with other commercial and industrial property; and (2) the value of BN's operating property. Colorado's method of equalization, i.e., a sales/assessment ratio study, was upheld in federal court. The court declined jurisdiction on the question of value. (No legal citation given.)

**Florida** -- Issues appealed in Florida have typically been associated with equalization. For tax years 1984 and 1985, Florida equalized railroads' assessments prior to publication of value, (similar to setting the assessed value in Montana.) (Nashville Railroad Co. v. Florida Department of Revenue, 736 S.2d 1495 (1984)).

**Kansas** -- Burlington Northern appealed its valuation under the 4-R Act in 1982 (573 F.Supp. 115 (D. Kan. 1982)). The decision was upheld by the 10th Circuit Court in 1983 (Burlington Northern RR v. Lennen, 715 F.2d 494 (1983)). The U.S. Supreme Court denied certiorari. [Federal courts have been reluctant to review valuation under the 4-R Act since its implementation, unless there has been a clear attempt to retaliate or circumvent 4-R Act relief.]

**Minnesota** -- Between 1980 and 1983, five different railroads brought a total of 14 separate lawsuits against the Minnesota Department of Revenue. The issues of

the cases were that the values of the railroads established by the Minnesota DOR were too high. The Minnesota Tax Court ruled in favor of the railroads and established a method for determining the value of railroad operating property. (No legal citations given.)

**Montana** -- BN sued in federal district court claiming discrimination under the 4-R Act due to a lack of equalizing values. The case was settled out of court by BN and the DOR agreeing to equalization factors for tax years 1983, 1984, and 1985.

**Nebraska** -- The Federal District Court in Lincoln, Nebraska, issued an opinion (unpublished) that rail transportation property should be valued at the "weighted mean" of other [commercial and industrial] property. The court required Nebraska to roll-back the railroads' valuation to the weighted mean. (No legal citation given.)

**North Dakota** -- A 1979 decision held that the assessment level for railroads could be no higher than that applicable to commercial and industrial property generally. Commercial and industrial property was exempt; consequently, railroad operating personality must also be exempted. (*Ogilvie v. State Board of Equalization*, 492 F.Supp. 446 (D. N.D. 1980), *affd.* 657 F.2d 204 (8th Cir. (1981)), *cert. den.* \_\_\_\_ U.S. \_\_\_\_, 102 S.Ct. 644 (1981)). A 1980 decision held that a 5% discount for early payment available to real property taxpayers must also be made available to railroads. (No citation given.)

**South Dakota** -- A statutory 60% assessment level was applicable to railway operating property as it was to other types of [commercial and industrial] property. (*Chicago, M., St.P. & P. Ry. Co. v. Gillis*, 80 S.D. 50, 118 N.W. 2d 313 (1982)).

**Wisconsin** -- Five railroads appealed the 1981 repeal of previously allowed [state] tax credits. The railroads prevailed in both state and federal courts. The five railroads appealing were: BN; Chicago and North Western; Green Bay and Western; Soo Line; and C.M.St.P. & P. (U.S. Dist. Ct. No. 81-C-772 (3-29-85), and Dane County Circuit Court Memorandum Decision, No. 82 CV 6025 (11-7-85)).

**Wyoming** -- The issue in the case was equalization. Wyoming and BN settled out of court.

## Miscellaneous Gleanings from Survey Responses

The responses provided by the 18 states returning the survey questionnaire allow something more than a shallow look at railroad taxation generally and, more specifically, the taxation of BN railroad operating property. For the interested reader additional information is available in the appendices following this narrative.

While a quick perusal of informational tables usually provides many interesting tidbits, more critical analysis typically leads to the discovery of some real nuggets. That may be true here, as well, if the data were only subjected to some critical analysis.

However, some not-so-critical analysis also grants some satisfaction. The following is what Frank Bryan<sup>4</sup> would refer to as the results of "barefoot empiricism".

**MORE ON BN's UNIT VALUE Re: Variation --** Table 1 lists the unit value of BN's operating railroad property in 14 states. The range of values runs from a low of \$2.447 billion in Wyoming<sup>5</sup> to a high of \$4.434 billion in Washington. The arithmetic mean (average) for the 14 states listed is \$3.177 billion. Therefore, the variation in unitary value as a percentage of the mean unitary value is well over 50%.

Some variation in the range of values would be expected given the differences of the weighting schemes used by the various states to arrive at the unitary value. (See appendix B.) However, the different weighting schemes do not explain the entire range of unit values. For example, examine some data from Illinois, Montana, and Washington.

---

<sup>4</sup> Dr. Bryan is currently a professor of Political Science at the University of Vermont at Burlington, Vermont. He was formerly the head of the Political Science Department at Montana State University. He is the author of several books on state legislative voting patterns and many articles on various political issues.

<sup>5</sup> Interestingly, a Wyoming tax official noted that Wyoming's \$2.447 billion unitary value of BN was actually a negotiated figure that was arrived at in an effort to avoid litigation. Wyoming's actual calculations for BN's unitary value indicates a value of \$5.315 billion, the highest of any state responding to the survey.

| <u>State</u> | <u>Weights<br/>(I/M/C)</u> | <u>Unit<br/>Value</u> |
|--------------|----------------------------|-----------------------|
| Illinois     | 70/10/20                   | \$2.800 billion       |
| Montana      | 50/40/10                   | \$3.462 billion       |
| Washington   | 75/5/20                    | \$4.434 billion       |

It is clear that the weighting scheme used in Washington is much closer to that used in Illinois than that used in Montana, but the resulting unit values certainly cause some wonder. Different periods of income, different indices of cost, or different weighting of market indicators could all be partially responsible for the large difference in value.

**Re: Unitary Value and Allocation --** It is most unfortunate that all of the states having BN operating property did not respond to the survey question regarding the portion of BN's unit value allocated to their respective state. It is unfortunate because how each state allocates BN's value should be of interest to each of the other states having BN operating property in their state; certainly each state would want assurance that it was getting its fair share of the pie. Table 2 provides some answers to the BN pie questions.

If the 17 responding states' allocated values for BN is totalled, the sum of those values is \$2,761.774 million, an average of \$162.457 million for each of the 17 states.

If that \$162 million average is applied to the other seven states (that did not respond) in which BN has property, another \$1,137.189 million in value can be assumed. This would indicate a total unit value for BN of \$3,898.933 million.

That \$3.9 billion is certainly more than the \$3.176 billion indicated by the 17-state average unit value that can be derived from Table 1. It is also more than all but 2 of the 14 states reporting their unit value (3 if you will allow Wyoming's real unitary value.)

What this analysis points out is unclear. If viewed from one perspective, it could appear that two states inappropriately overvalue BN's property. If this is the case, BN has access to redress in court.

If viewed from another perspective, it could appear that at least 12 states are foregoing a substantial amount of unitary value that really exists. If this latter case is true, the result is either unrealized tax revenues or in tax shifting from BN's undervalued property to all accurately valued taxpayers' property.

**Re: Allocation as a Percentage of Unit Value** -- Another way to look at the allocation of BN's unit value is as a percentage of the unit value. This can be accomplished by dividing each state's allocated value by that state's calculation of BN's unitary value. The results of such an exercise are contained in Table 6.

It is apparent from the data in Table 6 that some states consider more of BN's property to be in their state than do others. This would be expected given the level of BN's investment and activity in each of the states.

What is more interesting, however, is that 14 of the 24 states in which BN has property claim to have 84.6% of BN's total value. That leaves only 15.4% to be divided among the other 10 states.

TABLE 6

BN's Allocated Value as Percentage of BN's Unit Value  
(Alphabetical by State)

| State          | BN Unit<br>Value<br>(Billions) | BN Value<br>In State<br>(Millions) | Allocated<br>as a % of<br>Unit |
|----------------|--------------------------------|------------------------------------|--------------------------------|
| =====          | =====                          | =====                              | =====                          |
| Arkansas *     | 3.000                          | 29.700                             | 0.990%                         |
| Colorado       | 2.999                          | 93.859                             | 3.130%                         |
| Florida        | NA                             | 2.760                              | NA                             |
| Idaho          | 4.398                          | 61.119                             | 1.390%                         |
| Illinois       | 2.800                          | 95.600                             | 3.414%                         |
| Kansas         | 3.200                          | 49.110                             | 1.535%                         |
| Kentucky       | NA                             | 0.125                              | NA                             |
| Minnesota      | 2.764                          | 232.100                            | 8.397%                         |
| Montana        | 3.462                          | 489.191                            | 14.130%                        |
| Nebraska       | 2.900                          | 447.500                            | 15.431%                        |
| New Mexico     | 2.974                          | 25.636                             | 0.862%                         |
| North Dakota   | 3.094                          | 246.306                            | 7.961%                         |
| Oregon *       | NA                             | 97.108                             | NA                             |
| South Dakota   | NA                             | NA                                 | NA                             |
| Texas *        | 3.000                          | 156.000                            | 5.200%                         |
| Washington     | 4.434                          | 396.800                            | 8.949%                         |
| Wisconsin      | 3.000                          | 81.951                             | 2.732%                         |
| Wyoming        | 2.447                          | 256.909                            | 10.499%                        |
| <b>TOTAL</b>   | <b>44.472</b>                  | <b>2761.774</b>                    | <b>84.619%</b>                 |
| <b>AVERAGE</b> | <b>3.176571</b>                | <b>162.4572</b>                    | <b>6.044%</b>                  |

Each of the 14 states reporting both their calculated unitary value of BN and the allocated portion of BN's unit value claims an average of 6.044% of the total BN pie. If each of the nonreporting other ten states claimed the same 6.044%, the total pie would be 145% of what is indicated by the average slice.

**Re: Allocation of the Average Unit Value --** As with most statistics, there is yet another way of looking at the data in Tables 1 and 2. The way being referred to is to examine the allocated value as a percentage of the 14-state average unit value. This exercise is accomplished in Table 7.

TABLE 7  
Allocated Value as a Percentage of the Average Unit Value  
(Alphabetical by State)

| State<br>===== | Allocated<br>as a %<br>of Avg.<br>Unit<br>===== |
|----------------|-------------------------------------------------|
| Arkansas *     | 0.935%                                          |
| Colorado       | 2.955%                                          |
| Florida        | 0.087%                                          |
| Idaho          | 1.924%                                          |
| Illinois       | 3.010%                                          |
| Kansas         | 1.546%                                          |
| Kentucky       | 0.004%                                          |
| Minnesota      | 7.307%                                          |
| Montana        | 15.400%                                         |
| Nebraska       | 14.088%                                         |
| New Mexico     | 0.807%                                          |
| North Dakota   | 7.754%                                          |
| Oregon *       | 3.057%                                          |
| South Dakota   | 0.000%                                          |
| Texas *        | 4.911%                                          |
| Washington     | 12.491%                                         |
| Wisconsin      | 2.580%                                          |
| Wyoming        | 8.088%                                          |
| TOTAL          | 86.942%                                         |
| AVERAGE        | 5.114%                                          |

What happens when the allocated values are viewed as a percentage of the average unitary value is interesting. The state average of value allocated drops from 6.044% to 5.114%. Additionally, for the 17 states reporting their allocated value, the total portion of the pie claimed increases to only 86.9%, leaving 13.1% for the nonreporting 7 states.

Therefore, if the average unitary value is the bench mark of measure and all 24 of the "BN states" claimed the indicated 5.114%, the "slice of the pie" average indicator suggests a pie 122% of the average unit pie. (This is somewhat better than the 145% indicated by the previous measure, but indicates either some slice-hogging, i.e., overallocation, by some or all of the states or considerable undervaluation of the BN system by a number of the states.)

**MORE ON BN's TAXABLE VALUE** -- Recalling that the term "taxable value" means, in this discussion, the value of a property against which mill levies are assessed, it is important to know how that figure is arrived at. In every state, the foundation of taxable value is the assessed value or appraised value. This assessed value is then subjected to an "assessment rate", a "taxable rate", or perhaps both. Whatever the procedure, the final value is the taxable value.

Analyzing the data in Tables 1 and 3, a clearer picture can be painted of what states' taxable value of BN's property is in relationship to the allocated value. This can be accomplished by dividing the taxable value of BN's property in a state by the allocated value of BN's property in that state. Table 8 shows the results of such an exercise.

**TABLE 8**  
Taxable Value as a Percentage of the Allocated Value  
(Alphabetical by State)

| State          | BN Taxable<br>in State<br>(Millions) | BN Unit<br>Value<br>In State<br>(Millions) | Tax Rate<br>(BN Taxable<br>Divd. by<br>BN Unit) |
|----------------|--------------------------------------|--------------------------------------------|-------------------------------------------------|
| =====          | =====                                | =====                                      | =====                                           |
| Arkansas *     | NA                                   | 29.700                                     | NA                                              |
| Colorado       | 92.857                               | 93.859                                     | 98.932%                                         |
| Florida        | 2.346                                | 2.760                                      | 85.000%                                         |
| Idaho          | 61.119                               | 61.119                                     | 100.000%                                        |
| Illinois       | 31.900                               | 95.600                                     | 33.368%                                         |
| Kansas         | 9.655                                | 49.110                                     | 19.660%                                         |
| Kentucky       | 0.125                                | 0.125                                      | 100.000%                                        |
| Minnesota      | 122.300                              | 232.100                                    | 52.693%                                         |
| Montana        | 35.368                               | 489.191                                    | 7.230%                                          |
| Nebraska       | 362.200                              | 447.500                                    | 80.939%                                         |
| New Mexico     | 4.086                                | 25.636                                     | 15.939%                                         |
| North Dakota   | 8.500                                | 246.306                                    | 3.451%                                          |
| Oregon *       | 97.108                               | 97.108                                     | 100.000%                                        |
| South Dakota   | NA                                   | NA                                         | NA                                              |
| Texas *        | 156.000                              | 156.000                                    | 100.000%                                        |
| Washington     | 371.899                              | 396.800                                    | 93.725%                                         |
| Wisconsin      | 81.551                               | 81.951                                     | 100.000%                                        |
| Wyoming        | 26.975                               | 256.909                                    | 10.500%                                         |
| <b>TOTAL</b>   | <b>1464.389</b>                      | <b>2761.774</b>                            | <b>1001.436%</b>                                |
| <b>AVERAGE</b> | <b>91.524312</b>                     | <b>162.45729</b>                           | <b>62.590%</b>                                  |

What this analysis shows is that the tax rate measured by dividing the taxable value by the allocated unit value does not always correspond to the taxable rate or assessment rate reported by the states.

In Montana, for example, the statutory tax rate applicable to BN (and other railroads) is 15%; that was the rate reported and the rate required statutorily. (See Appendix B.) However, if BN's taxable value in Montana is divided by the reported amount of BN's unit value allocated to Montana, the taxable rate dips to 7.23%.

The 7.23% can be explained by the fact that for 1985 Montana adjusted BN's allocated value downward by 51.8% to comply with an out-of-court settlement reached with BN in 1983. The lower allocated value, after the adjustment, multiplied by the statutory 15% taxable rate accounts for the taxable value.

What goes on in states other than Montana cannot be explained from the data at hand, but from the figures listed in Table 8 and Appendix B, it is clear that some adjustments are made.

## **SUMMARY**

Perhaps only one conclusion can be drawn from the data and analysis provided in this part: property taxation -- especially interstate transportation property taxation -- is a complex issue.

Calculating an accurate unitary value is a difficult task. Allocating the proper amount of the unitary value to each state is difficult. Determining the appropriate level of assessment for equalization purposes is difficult. There simply is nothing about the taxation of railroad operating property that is not complex.

The data provided in this report and the analysis of the data answers some questions about railroad taxation, but leaves at least as many unanswered. Because of the volatility of property tax issues, it may simply be that sufficient analysis cannot be had to adequately answer all of the questions.

## SELECTED REFERENCES

- Cristy, George A., Moderator; "The Income Approach: A Panel Discussion"; Wichita Workshop on Appraisal of Utilities and Railroad Property for Ad Valorem Taxation; Wichita State University, Wichita, Kansas; August 6, 1984.
- Fletcher, Gregory G.; "Significant Court Cases Concerning Ad Valorem Taxation of Public Utility and Railroad Property"; Wichita Public Utilities Workshop Program on Appraisal of Public Utility and Railroad Property for Ad Valorem Taxation; Wichita State University, Wichita, Kansas; August 7, 1984.
- McSwain, Robert H. and Shank, David W.; Course Syllabus; presented at the Fourteenth Annual Program on the Appraisal of Utilities and Railroad Property for Ad Valorem Taxation; Wichita State University, Wichita, Kansas, August 6-9, 1984.
- Oppedahl, R. James (Jim); "Options for Complying with the 4-R Act and Similar Federal Legislation"; memorandum to the Revenue Oversight Committee; Montana Legislative Council; Helena, Montana; May 29, 1984.
- Thompson, Dennis L.; Taxation of American Railroads: A Policy Analysis; Greenwood Press, Westport, Connecticut, 1981.
- Western Association of Tax Administrators; Report of Committee on Railroad and Utility Valuation 1971; National Association of Tax Administrators, 1313 E. 60th Street, Chicago, Illinois.



## **APPENDIX A**

### **Survey Questionnaire Sent To States Having Burlington Northern Railroad Operating Property**

The following survey instrument was sent to the legislative research office in each of the 23 states, other than Montana, in which the Burlington Northern Railroad owns railroad operating property. The results of survey responses were compiled by Montana Legislative Council staff during the fall of 1985.



APPENDIX A

## REVENUE OVERSIGHT COMMITTEE

### MONTANA STATE LEGISLATURE

#### SENATE MEMBERS

Robert J. (Bob) Brown  
Vice Chairman  
Bruce D. Crippen  
Thomas O. Hager  
Joseph P. Mazurek  
William J. (Bill) Norman  
Thomas E. Towe

#### HOUSE MEMBERS

J. Melvin (Mel) Williams  
Chairman  
Gerry Devlin  
John G. Harp  
Dan W. Harrington  
Nancy A. Keenan  
Jack Ramirez

Dave Bohyer  
Staff Researcher  
(406) 444-3064

November 26, 1985

The Montana Legislature is currently assessing the state's taxation policy vis a vis railroad transportation property; in Montana that means (almost exclusively) the Burlington Northern Railroad.

My map of BN's rail system shows that its lines run through [state name]. Because BN has property there, I am asking for your assistance in determining how railroads, especially BN, are taxed in [state name].

Montana's Legislature's tax policy committee, the Revenue Oversight Committee, is meeting the first week in January to begin examining this issue. Consequently, I would greatly appreciate it if you would complete the enclosed questionnaire and return it to me by December 11.

Please call me if you have any questions. And thank you for your assistance!

Sincerely,

A handwritten signature in cursive script that reads "David D. Bohyer".

David D. Bohyer  
Staff Researcher

db/BN/dw3

BURLINGTON NORTHERN RAILROAD  
PROPERTY TAX QUESTIONNAIRE

\*\*\*\*\*

In Montana, state law requires that all property be assessed at "market value". This sometimes is referred to as "full market value", "true market value", or "true cash value". Whatever the terminology, it is taken to mean the value at which property would change hands between a willing buyer and a willing seller.

Once the market value is determined, a "taxable rate" is applied to it resulting in a "taxable value". It is this "taxable value" against which mill levies are assessed. (In some states these terms are referred to as the "assessment ratio" or "level of assessment", and "assessed value", respectively. Whatever the terminology, the resulting value is the value against which mill levies are assessed.)

Regarding the valuation of railroad property, Montana uses what is commonly referred to as the "unitary method" of valuation where, first, the value of the entire railroad's operation is determined, and second, the state's proportionate share is apportioned to Montana. The value determined includes the value of all real and personal operating property owned by the railroad.

For 1985, Montana's estimate of the unitary value of BN's rail property was \$3.462 billion. According to our Department of Revenue, Montana's proportionate share of the unitary value (14.13%) amounted to \$489.2 million.

With this as a background, would you please answer the following questions, using as a base year the most recent year for which tax data is available.

\*\*\*\*\*

Base year \_\_\_\_\_ State \_\_\_\_\_

1. a. Preliminary research indicates that virtually every state uses the "unitary method" to establish the value of railroad operating property. Does your state use the unitary method? \_\_\_\_\_ Yes \_\_\_\_\_ No

b. If you use the unitary method, what weights are assigned to each component method used to establish the unitary value? (If different weights are used for different railroads, please list the weights used for BN.)

\_\_\_\_\_ % Income \_\_\_\_\_ % Market \_\_\_\_\_ % Cost  
\_\_\_\_\_ % Other (describe) \_\_\_\_\_

c. If you do not use the unitary method, what method do you use to establish the value of railroad operating property?

\_\_\_\_\_  
\_\_\_\_\_

2. How is railroad personal property treated in your state?

- \_\_\_\_\_ a. taxable  
\_\_\_\_\_ b. taxable, but differently from realty  
\_\_\_\_\_ c. exempt  
\_\_\_\_\_ d. Other (please explain) \_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_

3. What is the (unitary) value of Burlington Northern's railroad property in your state? \$ \_\_\_\_\_

4. What is the value of BN's property apportioned to your state?  
\$ \_\_\_\_\_

5. What is the taxable value of BN's property in your state?  
\$ \_\_\_\_\_

6. a. What is the "taxable rate" or "assessment ratio" applicable to BN's railroad property? \_\_\_\_\_%

b. Who has the responsibility to establish the rate?

\_\_\_\_\_ the Legislature

\_\_\_\_\_ an administrative agency

\_\_\_\_\_ Other (please specify) \_\_\_\_\_

7. What amount did BN pay in property tax? \$ \_\_\_\_\_

8. a. Have any of the railroads in your state appealed their assessment using the provisions of section 306 of the Railroad Revitalization and Regulatory Reform Act of 1976 as the basis for their appeal? \_\_\_\_\_ Yes \_\_\_\_\_ No

b. If so, would you please give a brief description of the issues involved and the ruling (include citation please).

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

9. Would you be interested in receiving a copy of the compiled results of this survey? \_\_\_\_\_ Yes \_\_\_\_\_ No

Contact person \_\_\_\_\_

Agency \_\_\_\_\_

Address \_\_\_\_\_

Telephone \_\_\_\_\_

## APPENDIX B

### BURLINGTON NORTHERN TAX DATA FROM 18 STATES

TABLE 9  
BURLINGTON NORTHERN TAXATION DATA

| State        | BN Unit<br>Value<br>(Billions) |
|--------------|--------------------------------|
| =====        | =====                          |
| Arkansas     | 3.000                          |
| Colorado     | 2.999                          |
| Florida      | NA                             |
| Idaho        | 4.398                          |
| Illinois     | 2.800                          |
| Kansas       | 3.200                          |
| Kentucky     | NA                             |
| Minnesota    | 2.764                          |
| Montana      | 3.462                          |
| Nebraska     | 2.900                          |
| New Mexico   | 2.974                          |
| North Dakota | 3.094 aa                       |
| Oregon       | NA ii                          |
| South Dakota | NA                             |
| Texas        | 3.000                          |
| Washington   | 4.434                          |
| Wisconsin    | 3.000                          |
| Wyoming      | 2.447 vv                       |

TABLE 10  
BURLINGTON NORTHERN TAXATION DATA

| State        | BN Value<br>In State<br>(Millions) |    |
|--------------|------------------------------------|----|
| =====        |                                    |    |
| Arkansas     | 29.700                             |    |
| Colorado     | 93.859                             |    |
| Florida      | 2.760                              |    |
| Idaho        | 61.119                             |    |
| Illinois     | 95.600                             |    |
| Kansas       | 49.110                             |    |
| Kentucky     | 0.125                              |    |
| Minnesota    | 232.100                            | k  |
| Montana      | 489.191                            | r  |
| Nebraska     | 447.500                            |    |
| New Mexico   | 25.636                             |    |
| North Dakota | 246.306                            | bb |
| Oregon       | 97.108                             | jj |
| South Dakota | NA                                 |    |
| Texas        | 156.000                            |    |
| Washington   | 396.800                            |    |
| Wisconsin    | 81.951                             |    |
| Wyoming      | 256.909                            |    |

TABLE 11  
BURLINGTON NORTHERN TAXATION DATA

| State        | BN Taxable<br>in State<br>(Millions) |    |
|--------------|--------------------------------------|----|
| =====        |                                      |    |
| Arkansas     | NA                                   | a  |
| Colorado     | 92.857                               | b  |
| Florida      | 2.346                                |    |
| Idaho        | 61.119                               |    |
| Illinois     | 31.900                               |    |
| Kansas       | 9.655                                |    |
| Kentucky     | 0.125                                |    |
| Minnesota    | 122.300                              | l  |
| Montana      | 35.368                               | s  |
| Nebraska     | 362.200                              | v  |
| New Mexico   | 4.086                                |    |
| North Dakota | 8.500                                | cc |
| Oregon       | 97.108                               |    |
| South Dakota | NA                                   |    |
| Texas        | 156.000                              | nn |
| Washington   | 371.899                              |    |
| Wisconsin    | 81.951                               |    |
| Wyoming      | 26.975                               |    |

TABLE 12  
BURLINGTON NORTHERN TAXATION DATA

| State        | Tax<br>Rate<br>(Percent) |       |
|--------------|--------------------------|-------|
| =====        | =====                    | ===== |
| Arkansas     | NA                       | a     |
| Colorado     | 14.000                   |       |
| Florida      | NA                       | d     |
| Idaho        | 100.000                  |       |
| Illinois     | 33 1/3                   |       |
| Kansas       | 19.660                   | h     |
| Kentucky     | 100.000                  |       |
| Minnesota    | 43.000                   | m     |
| Montana      | 15.000                   |       |
| Nebraska     | 80.000                   | w     |
| New Mexico   | 33 1/3                   | z     |
| North Dakota | 10.000                   | dd    |
| Oregon       | 100.000                  |       |
| South Dakota | NA                       | ll    |
| Texas        | 100.000                  |       |
| Washington   | 93.700                   | qq    |
| Wisconsin    | 100.000                  |       |
| Wyoming      | 10.500                   |       |

Note: This table was printed  
as Table 4 in the narrative.

TABLE 13  
BURLINGTON NORTHERN TAXATION DATA

| State        | Property<br>Tax Paid<br>(Millions) |    |
|--------------|------------------------------------|----|
| =====        |                                    |    |
| Arkansas     | NA                                 |    |
| Colorado     | NA                                 |    |
| Florida      | 0.037                              |    |
| Idaho        | NA                                 |    |
| Illinois     | NA                                 |    |
| Kansas       | 1.254                              | i  |
| Kentucky     | 0.001                              |    |
| Minnesota    | 5.300                              | n  |
| Montana      | 8.535                              |    |
| Nebraska     | 10.300                             |    |
| New Mexico   | 0.080                              |    |
| North Dakota | 1.486                              |    |
| Oregon       | 1.118                              |    |
| South Dakota | NA                                 |    |
| Texas        | NA                                 |    |
| Washington   | 3.583                              | rr |
| Wisconsin    | 1.846                              |    |
| Wyoming      | 1.819                              |    |

TABLE 14  
BURLINGTON NORTHERN TAXATION DATA

| State           | BN Unit<br>Value<br>(Billions) |    |
|-----------------|--------------------------------|----|
| =====           | =====                          |    |
| 1 Washington    | 4.434                          |    |
| 2 Idaho         | 4.398                          |    |
| 3 Montana       | 3.462                          |    |
| 4 Kansas        | 3.200                          |    |
| 5 North Dakota  | 3.094                          | aa |
| 6 Arkansas      | 3.000                          |    |
| 7 Texas         | 3.000                          |    |
| 8 Wisconsin     | 3.000                          |    |
| 9 Colorado      | 2.999                          |    |
| 10 New Mexico   | 2.974                          |    |
| 11 Nebraska     | 2.900                          |    |
| 12 Illinois     | 2.800                          |    |
| 13 Minnesota    | 2.764                          |    |
| 14 Wyoming      | 2.447                          | vv |
| 15 Florida      | NA                             |    |
| 16 Kentucky     | NA                             |    |
| 17 Oregon       | NA                             | ii |
| 18 South Dakota | NA                             |    |

Note: This table was printed as  
Table 1 in the narrative.

TABLE 15  
BURLINGTON NORTHERN TAXATION DATA

| State           | BN Value<br>In State<br>(Millions) |    |
|-----------------|------------------------------------|----|
| =====           |                                    |    |
| 1 Montana       | 489.191                            | r  |
| 2 Nebraska      | 447.500                            |    |
| 3 Washington    | 396.800                            |    |
| 4 Wyoming       | 256.909                            |    |
| 5 North Dakota  | 246.306                            | bb |
| 6 Minnesota     | 232.100                            | k  |
| 7 Texas         | 156.000                            |    |
| 8 Oregon        | 97.108                             | jj |
| 9 Illinois      | 95.600                             |    |
| 10 Colorado     | 93.859                             |    |
| 11 Wisconsin    | 81.951                             |    |
| 12 Idaho        | 61.119                             |    |
| 13 Kansas       | 49.110                             |    |
| 14 Arkansas     | 29.700                             |    |
| 15 New Mexico   | 25.636                             |    |
| 16 Florida      | 2.760                              |    |
| 17 Kentucky     | 0.125                              |    |
| 18 South Dakota | NA                                 |    |

Note: This table was printed as  
Table 2 in the narrative.

TABLE 16  
BURLINGTON NORTHERN TAXATION DATA

| State           | BN Taxable<br>in State<br>(Millions) |    |
|-----------------|--------------------------------------|----|
| =====           | =====                                |    |
| 1 Washington    | 371.899                              |    |
| 2 Nebraska      | 362.200                              | v  |
| 3 Texas         | 156.000                              | nn |
| 4 Minnesota     | 122.300                              | l  |
| 5 Oregon        | 97.108                               |    |
| 6 Colorado      | 92.857                               | b  |
| 7 Wisconsin     | 81.951                               |    |
| 8 Idaho         | 61.119                               |    |
| 9 Montana       | 35.368                               | s  |
| 10 Illinois     | 31.900                               |    |
| 11 Wyoming      | 26.975                               |    |
| 12 Kansas       | 9.655                                |    |
| 13 North Dakota | 8.500                                | cc |
| 14 New Mexico   | 4.086                                |    |
| 15 Florida      | 2.346                                |    |
| 16 Kentucky     | 0.125                                |    |
| 17 Arkansas     | NA                                   | a  |
| 18 South Dakota | NA                                   |    |

Note: This table was printed as  
Table 3 in the narrative.

TABLE 17  
BURLINGTON NORTHERN TAXATION DATA

| State           | Tax<br>Rate<br>(Percent) |    |
|-----------------|--------------------------|----|
| =====           |                          |    |
| 1 Idaho         | 100.000                  |    |
| 2 Kentucky      | 100.000                  |    |
| 3 Oregon        | 100.000                  |    |
| 4 Texas         | 100.000                  |    |
| 5 Wisconsin     | 100.000                  |    |
| 6 Washington    | 93.700                   | qq |
| 7 Nebraska      | 80.000                   | w  |
| 8 Minnesota     | 43.000                   | m  |
| 9 Illinois      | 33.333                   |    |
| 10 New Mexico   | 33.333                   | z  |
| 11 Kansas       | 19.660                   | h  |
| 12 Montana      | 15.000                   |    |
| 13 Colorado     | 14.000                   |    |
| 14 Wyoming      | 10.500                   |    |
| 15 North Dakota | 10.000                   | dd |
| 16 Arkansas     | NA                       | a  |
| 17 Florida      | NA                       | d  |
| 18 South Dakota | NA                       | ll |

TABLE 18  
BURLINGTON NORTHERN TAXATION DATA

| State           | Property<br>Tax Paid<br>(Millions) |    |
|-----------------|------------------------------------|----|
| =====           | =====                              |    |
| 1 Nebraska      | 10.300                             |    |
| 2 Montana       | 8.535                              |    |
| 3 Minnesota     | 5.300                              | n  |
| 4 Washington    | 3.583                              | rr |
| 5 Wisconsin     | 1.846                              |    |
| 6 Wyoming       | 1.819                              |    |
| 7 North Dakota  | 1.486                              |    |
| 8 Kansas        | 1.254                              | i  |
| 9 Oregon        | 1.118                              |    |
| 10 New Mexico   | 0.080                              |    |
| 11 Florida      | 0.037                              |    |
| 12 Kentucky     | 0.001                              |    |
| 13 Arkansas     | NA                                 |    |
| 14 Colorado     | NA                                 |    |
| 15 Idaho        | NA                                 |    |
| 16 Illinois     | NA                                 |    |
| 17 South Dakota | NA                                 |    |
| 18 Texas        | NA                                 |    |

Note: This table was printed as  
Table 5 in the narrative.

TABLE 19

## TAX DATA ON BURLINGTON NORTHERN RAILROAD - SELECTED RANKINGS

| State        | By BN<br>Unit<br>Value | By BN<br>Allocated<br>Value | By BN<br>Taxable<br>Value | By BN<br>Tax<br>Paid |
|--------------|------------------------|-----------------------------|---------------------------|----------------------|
| =====        | =====                  | =====                       | =====                     | =====                |
| Arkansas     | 6                      | 14                          | 17                        | 13                   |
| Colorado     | 9                      | 10                          | 6                         | 14                   |
| Florida      | 15                     | 16                          | 15                        | 11                   |
| Idaho        | 2                      | 12                          | 8                         | 15                   |
| Illinois     | 12                     | 9                           | 10                        | 16                   |
| Kansas       | 4                      | 13                          | 12                        | 8                    |
| Kentucky     | 16                     | 17                          | 16                        | 12                   |
| Minnesota    | 13                     | 6                           | 4                         | 3                    |
| Montana      | 3                      | 1                           | 9                         | 2                    |
| Nebraska     | 11                     | 2                           | 2                         | 1                    |
| New Mexico   | 10                     | 15                          | 14                        | 10                   |
| North Dakota | 5                      | 5                           | 13                        | 7                    |
| Oregon       | 17                     | 8                           | 5                         | 9                    |
| South Dakota | 18                     | 18                          | 18                        | 17                   |
| Texas        | 7                      | 7                           | 3                         | 18                   |
| Washington   | 1                      | 3                           | 1                         | 4                    |
| Wisconsin    | 8                      | 11                          | 7                         | 5                    |
| Wyoming      | 14                     | 4                           | 11                        | 6                    |

TABLE 20

## SELECTED DATA ON BN RAILROAD PROPERTY TAXATION FOR TAX YEAR 1985

| State        | Factor Weights (I/M/C) | BN Unit Value (Billions) | BN Value In State (Millions) | BN Taxable In State (Millions) | Tax Rate (Percent) | Property Tax Paid (Millions) | Railroad Valuation Appealed |
|--------------|------------------------|--------------------------|------------------------------|--------------------------------|--------------------|------------------------------|-----------------------------|
| Arkansas *   | 50/50/0                | 3.000                    | 29,700                       | NA a                           | NA a               | NA                           | Yes                         |
| Colorado     | 60/10/10               | 2.999                    | 93,859                       | 92,857 b                       | 14.000             | NA                           | Yes c                       |
| Florida      | 100/0/0                | NA                       | 2,346                        | 2,346                          | NA d               | 0.037                        | Yes e                       |
| Idaho        | f                      | 4.398                    | 61,119                       | 61,119                         | 100.000            | NA                           | No                          |
| Illinois     | 70/10/20               | 2.800                    | 95,600                       | 91,900                         | 33 1/3             | NA                           | No                          |
| Kansas       | q                      | 3.200                    | 49,110                       | 9,655                          | 19.660 h           | 1.254 i                      | Yes j                       |
| Kentucky     | NA                     | NA                       | 0.125                        | 0.125                          | 100.000            | 0.001                        | No                          |
| Minnesota    | 60/35/15               | 2.764                    | 232,100 k                    | 122,300 l                      | 43.000 m           | 5,300 n                      | Yes q                       |
| Montana      | 50/10/10               | 3.462                    | 486,191                      | 35,368 s                       | 15.000             | 8,535                        | Yes t                       |
| Nebraska     | u                      | 2.900                    | 447,500                      | 362,200 v                      | 80.000 w           | 10,300                       | Yes x                       |
| New Mexico   | 2.974                  | 2,974                    | 225,636                      | 8,086                          | 33 1/3 z           | 0.080                        | No                          |
| North Dakota | 65/25/10               | 3.094 aa                 | 246,306 bb                   | 8,500 cc                       | 10.000 dd          | 1.486                        | Yes ee                      |
| Oregon *     | ff                     | NA ii                    | 97,108 jj                    | 97,108                         | 100.000            | 1.118                        | Yes kk                      |
| South Dakota | NA                     | NA                       | NA                           | NA ll                          | NA ll              | NA                           | No                          |
| Texas *      | mm                     | 3.000                    | 156,000                      | 156,000 nn                     | 100.000            | NA                           | No                          |
| Washington   | 75/5/20                | 4.434                    | 396,800                      | 371,899                        | 93.700 qq          | 3,583 rr                     | Yes tt                      |
| Wisconsin    | ss                     | 3.000                    | 81,951                       | 81,951                         | 100.000            | 1.846                        | Yes tt                      |
| Wyoming      | uu                     | 2.447 vv                 | 256,909                      | 26,975                         | 10.500             | 1.819                        | Yes ww                      |

\* For tax year 1984

NOTES: Six states did not respond to the questionnaire: Alabama, California, Iowa, Mississippi, Missouri, and Tennessee. Personal property is exempt from property tax in Illinois, Minnesota, North Dakota, and South Dakota.

TABLE 21

## SELECTED TAXATION DATA ON BURLINGTON NORTHERN RAILROAD

| State<br>===== | BN Unit<br>Value<br>(Billions)<br>===== | BN Value<br>In State<br>(Millions)<br>===== | Allocated<br>as a % of<br>Unit<br>===== |
|----------------|-----------------------------------------|---------------------------------------------|-----------------------------------------|
| Arkansas *     | 3.000                                   | 29.700                                      | 0.990%                                  |
| Colorado       | 2.999                                   | 93.859                                      | 3.130%                                  |
| Florida        | NA                                      | 2.760                                       | NA                                      |
| Idaho          | 4.398                                   | 61.119                                      | 1.390%                                  |
| Illinois       | 2.800                                   | 95.600                                      | 3.414%                                  |
| Kansas         | 3.200                                   | 49.110                                      | 1.535%                                  |
| Kentucky       | NA                                      | 0.125                                       | NA                                      |
| Minnesota      | 2.764                                   | 232.100                                     | 8.397%                                  |
| Montana        | 3.462                                   | 489.191                                     | 14.130%                                 |
| Nebraska       | 2.900                                   | 447.500                                     | 15.431%                                 |
| New Mexico     | 2.974                                   | 25.636                                      | 0.862%                                  |
| North Dakota   | 3.094                                   | 246.306                                     | 7.961%                                  |
| Oregon *       | NA                                      | 97.108                                      | NA                                      |
| South Dakota   | NA                                      | NA                                          | NA                                      |
| Texas *        | 3.000                                   | 156.000                                     | 5.200%                                  |
| Washington     | 4.434                                   | 396.800                                     | 8.949%                                  |
| Wisconsin      | 3.000                                   | 81.951                                      | 2.732%                                  |
| Wyoming        | 2.447                                   | 256.909                                     | 10.499%                                 |
| TOTAL          | 44.472                                  | 2761.774                                    | 84.619%                                 |
| AVERAGE        | 3.176571                                | 162.4572                                    | 6.044%                                  |

\* Data for tax year 1984

Note: This table was printed as Table 6 in the narrative.

TABLE 22

## SELECTED TAXATION DATA ON BURLINGTON NORTHERN RAILROAD

| State<br>===== | Allocated<br>as a %<br>of Avg.<br>Unit<br>===== |
|----------------|-------------------------------------------------|
| Arkansas *     | 0.935%                                          |
| Colorado       | 2.955%                                          |
| Florida        | 0.087%                                          |
| Idaho          | 1.924%                                          |
| Illinois       | 3.010%                                          |
| Kansas         | 1.546%                                          |
| Kentucky       | 0.004%                                          |
| Minnesota      | 7.307%                                          |
| Montana        | 15.400%                                         |
| Nebraska       | 14.088%                                         |
| New Mexico     | 0.807%                                          |
| North Dakota   | 7.754%                                          |
| Oregon *       | 3.057%                                          |
| South Dakota   | 0.000%                                          |
| Texas *        | 4.911%                                          |
| Washington     | 12.491%                                         |
| Wisconsin      | 2.580%                                          |
| Wyoming        | 8.088%                                          |
| TOTAL          | 86.942%                                         |
| AVERAGE        | 5.114%                                          |

\* Data for tax year 1984

Note: This table was printed  
as Table 7 in the narrative

TABLE 23

## SELECTED TAXATION DATA ON BURLINGTON NORTHERN RAILROAD

| State<br>===== | Allocated<br>as a % of<br>Unit<br>===== | Allocated<br>as a %<br>of Avg.<br>Unit<br>===== |
|----------------|-----------------------------------------|-------------------------------------------------|
| Arkansas *     | 0.990%                                  | 0.935%                                          |
| Colorado       | 3.130%                                  | 2.955%                                          |
| Florida        | NA                                      | 0.087%                                          |
| Idaho          | 1.390%                                  | 1.924%                                          |
| Illinois       | 3.414%                                  | 3.010%                                          |
| Kansas         | 1.535%                                  | 1.546%                                          |
| Kentucky       | NA                                      | 0.004%                                          |
| Minnesota      | 8.397%                                  | 7.307%                                          |
| Montana        | 14.130%                                 | 15.400%                                         |
| Nebraska       | 15.431%                                 | 14.088%                                         |
| New Mexico     | 0.862%                                  | 0.807%                                          |
| North Dakota   | 7.961%                                  | 7.754%                                          |
| Oregon *       | NA                                      | 3.057%                                          |
| South Dakota   | NA                                      | 0.000%                                          |
| Texas *        | 5.200%                                  | 4.911%                                          |
| Washington     | 8.949%                                  | 12.491%                                         |
| Wisconsin      | 2.732%                                  | 2.580%                                          |
| Wyoming        | 10.499%                                 | 8.088%                                          |
| TOTAL          | 84.619%                                 | 86.942%                                         |
| AVERAGE        | 6.044%                                  | 5.114%                                          |

\* Data for tax year 1984

TABLE 24

## SELECTED TAXATION DATA ON BURLINGTON NORTHERN RAILROAD

| State        | BN Taxable<br>in State<br>(Millions) | BN Unit<br>Value<br>In State<br>(Millions) | Tax Rate<br>(BN Taxable<br>Dvd. by<br>BN Unit) |
|--------------|--------------------------------------|--------------------------------------------|------------------------------------------------|
| =====        | =====                                | =====                                      | =====                                          |
| Arkansas *   | NA                                   | 29.700                                     | NA                                             |
| Colorado     | 92.857                               | 93.859                                     | 98.932%                                        |
| Florida      | 2.346                                | 2.760                                      | 85.000%                                        |
| Idaho        | 61.119                               | 61.119                                     | 100.000%                                       |
| Illinois     | 31.900                               | 95.600                                     | 33.368%                                        |
| Kansas       | 9.655                                | 49.110                                     | 19.660%                                        |
| Kentucky     | 0.125                                | 0.125                                      | 100.000%                                       |
| Minnesota    | 122.300                              | 232.100                                    | 52.693%                                        |
| Montana      | 35.368                               | 489.191                                    | 7.230%                                         |
| Nebraska     | 362.200                              | 447.500                                    | 80.939%                                        |
| New Mexico   | 4.086                                | 25.636                                     | 15.939%                                        |
| North Dakota | 8.500                                | 246.306                                    | 3.451%                                         |
| Oregon *     | 97.108                               | 97.108                                     | 100.000%                                       |
| South Dakota | NA                                   | NA                                         | NA                                             |
| Texas *      | 156.000                              | 156.000                                    | 100.000%                                       |
| Washington   | 371.899                              | 396.800                                    | 93.725%                                        |
| Wisconsin    | 81.951                               | 81.951                                     | 100.000%                                       |
| Wyoming      | 26.975                               | 256.909                                    | 10.500%                                        |
| TOTAL        | 1464.389                             | 2761.774                                   | 1001.436%                                      |
| AVERAGE      | 91.524312                            | 162.45729                                  | 62.590%                                        |

\* Data for tax year 1984

Note: This table was printed as Table 8 in the narrative.



## APPENDIX C

### FOOTNOTES FOR ALL TABLES CONTAINED IN PARTS ONE AND TWO AND IN APPENDIX B.

a Arkansas officials' response to the taxable value question was "unknown". Statutorily the assessment rate is 20% of market value. Sales/assessment ratio studies indicate that a 13% rate is applicable to commercial and industrial property. Consequently, it appears that the equalized value of BN's property in Arkansas should be about \$3,861,000, (\$29.7 million multiplied by 13%).

b Figure excludes locally assessed property.

c The issues involved in the Colorado appeals included: (1) equalization with other commercial and industrial property, and (2) valuation of the operating property. The court upheld Colorado's method of equalization [i.e., a sales/assessment ratio study], and declined jurisdiction on the question of valuation.

d A separate "assessment ratio" is used in each county based on the level of assessment for "commercial and industrial property" in that county. Each respective assessment ratio is applied to the value apportioned to each county resulting in an "equalized assessment" which is the basis for billing. Based on this procedure, it appears that 100% of the equalized value is subject to mill levies.

e Florida has been in court on several occasions over equalization issues. (Nashville Railroad Co. v. Florida DOR, (736 S.2d 1495 )1984) For tax years 1984 and 1985, railroad assessments were equalized prior to publication (i.e., the application of mill levies.)

f No "weighting" was reported by Idaho, however, for tax years following 1985 the weighting will be left to the judgment of the appraiser.

g The director of Kansas' property valuation agency correlates the value without a specific weighting scheme. Reportedly, "recent Directors have tended to place more emphasis on income, and less emphasis on cost indicators." (Tom Severn, Kansas Legislative Research Department.)

h An assessment level of approximately 19 percent was established in Atchison, Topeka, and Santa Fe v. Lennen, 552 F. Supp. 1031 (1982). In recent years, all Kansas railroads have become parties in the case.

i Actual tax paid in 1984. 1985 tax paid was not available when the narrative was written.

j Burlington Northern appealed its valuation under section (306) of the 4R Act in 1982, (573 F. Supp. 115 (D. Kan. 1982). The court decided in the state's favor and was upheld by the 10th Circuit Court in 1983, (BN RR. v. Lennen, 715 F. 2d 494 (10th Cir. 1983). The Supreme Court refused to review valuation under the 4R Act unless there has been a clear attempt to retaliate or circumvent 4R Act relief.

k It is not precisely clear what the \$232 million figure represents. In the 1984 tax year, BN's value allocated to Minnesota was about \$196 million. The \$196 million

figure included the value of exempt personal property (\$65,382,120) and of other exempt property (\$4,542,415). The unequalized portion of BN's value allocated to Minnesota amounted to slightly over \$127 million for tax year 1984. If the same deductions were made for exempt property for the 1985 tax year, Minnesota's allocated value would be about \$70 million less than the \$232 million figure.

l BN's taxable value in Minnesota is a function of the unit value, the allocated value, the assessment rate, and the sales/assessment ratio. The \$122 million figure appears to be the equalized value of the allocated portion of BN's unit value. It appears the \$122 million figure had not been subjected to the assessment ratio of 43% (for 1985). If the assessment ratio of 43% is applied to the reported taxable value, the resultant value and more accurate taxable value would be \$52,589,000.

m This was the 1985 assessment ratio reported by the Minnesota Department of Revenue.

n The \$5.3 million figure is apparently based on the \$122 million equalized value, multiplied by the 43% assessment rate, and further multiplied by the statewide average millage of about 100.000 mills.

q Between 1980 and 1983, five different railroads brought a total of 14 separate lawsuits against the Minnesota Department of Revenue. The issues of the cases were that the values of the railroads established by the Minnesota DOR were too high. The Minnesota Tax Court ruled in favor of the railroads and established a method for determining the value of railroad operating property.

r This value is the allocated value prior to adjustment per the 1982 out of court settlement. The adjustment factor for 1985 was 0.482, (48.2 percent).

s The \$35 plus million in taxable results from the allocated value multiplied by the adjustment factor (0.482), multiplied by the taxable rate (15%).

t The BN sued in federal district court in 1982, but a settlement was reached before the case went to trial.

u Nebraska has no required weighting scheme. The judgment of the appraiser is relied upon to reconcile the valuation indicators. State officials indicate the value derived from the "income approach" is the most heavily weighted indicator.

v This is the "equalized" value of BN's operating property in Nebraska. Author's assumption is that "equalizing" takes place to account for differences in assessment level of other commercial and industrial property.

w This is the "assessment ratio" rather than a taxable rate. The indication is that the amount of value subjected to mill levies is a function of the equalized value and the assessment ratio.

x The Federal District Court in Lincoln, Nebraska, issued an opinion (unpublished) that rail transportation property should be valued at the "weighted mean" of other [commercial and industrial] property. The court required Nebraska to roll back the railroads' valuation to the weighted mean.

y No specific weighting required. Correlation of values is left to the appraiser.

z The assessment ratio in Texas is 33 1/3% of true market value. Given the \$25.6 million figure for Texas' allocated value, the reported taxable value of \$4.085 million, and the assessment ratio of 33 1/3%, the indication is that another "taxable rate" multiplier exists and is approximately 48%.

aa North Dakota's unitary value excludes noncapitalized leased property.

bb The \$246 million figure represents the total of BN's operating real and personal property. Only \$172 million (the value of the operating realty) is taxable in ND because personalty is exempt.

cc North Dakota's \$8.5 million in taxable value results from the allocated value multiplied by the 50% assessment factor (49.287% for 1985), further multiplied by the 10% tax rate.

dd The 10% taxable rate is applied to 50% (i.e., the assessment ratio) of the apportioned value.

ee A 1979 4R Act decision ruled that the assessment level for railroads could be no higher than that applicable to commercial and industrial property. Commercial and industrial personal property was exempt; consequently, railroad operating personalty also had to be exempted, (*Ogilvie v. State board of Equalization*, 492 F. Supp. (D. ND 1980), affd. 657 F. 2d 204 (8th Cir. 1981), cert. den. \_\_\_\_ US \_\_\_\_, 102 S.Ct. 644 (1981). A 1980 4R Act decision ruled that a 5% discount for early payment available to real property taxpayers must also be made available to railroads, (*supra* *Ogilvie*).

ff The responsibility for assigning factor weights in Oregon lies solely with the appraiser. There is no set factor weighting.

ii The Oregon Department of Revenue would not disclose the unitary valuation.

jj The Oregon Department of Revenue established the value at \$97 million plus, but BN appealed contending \$58.1 million was the actual value. Oregon law requires the \$58.1 million to be used until resolution of the appeal.

kk In *Chicago, M., St.P.&P.Ry.Co. v. Gillis* (1962) 80 SD 50, 118 NW 2d 313, the court held that a statutory 60% assessment level was applicable to railway operating property as it was to other types of taxable property.

mm No specific weighting is required statutorily or administratively; weighting is left to the appraiser's judgment.

nn The response from the Texas State Property Tax Board reported that the "taxable value" was not available. However, Texas law requires full market valuation and assessment at 100%. Consequently, the taxable value should be the same as the state's allocated value, i.e., \$156 million.

qq The 93.7% figure is the statewide average assessment ratio. It appears that the property is taxable at 100% of its assessed value.

rr The \$3.583 million figure is based on Washington's 1984 equalized valuation for BN of \$315,725,000.

ss Weighting of valuation indicators is at the discretion of the appraiser.

tt Five railroads appealed the 1981 repeal of previously allowed tax credits. The railroads prevailed in both state and federal courts. The five railroads were: BN; Chicago and North Western; Green Bay and Western; Soo Line; and C.M.St.P.&P. (US District Court, #81-C-772(3-29-85) and Dane County Circuit Court Memorandum Decision #82 CV 6025 (11-7-85).)

uu No specific weighting scheme is required. The weighting is left to the judgment of the appraiser.

vv This value reflects efforts between Wyoming and BN to work out 4R issues. Wyoming's actual estimate of value for BN's operating system is \$5.315 billion.

ww The issue in the case was equalization. Wyoming and BN settled out of court.

## CHAPTER THREE

### Revisiting Options for Determining the Tax Rate Applicable to Burlington Northern Railroad's Property

#### INTRODUCTION

The following quotations are illustrative of the diversity of opinion during the 1985-86 interim regarding the taxation of the Burlington Northern Railroad. All of the quotes follow the November 1985 announced closure of the BN's diesel repair shops in Livingston and the governor's subsequent pledge to work toward a reconsideration of BN's property taxes in a special legislative session.

[The 1985 Montana Legislature's decision to double the property tax rate for railroads] had absolutely nothing to do with [BN's decision to close its Livingston maintenance shop]. [Montana's business climate in general] had nothing to do with the Livingston closing. We have two shops and only need one. West Burlington is better suited for the job.

Brian Sweeney, BN Director of Corporate Communication, November 6, 1985,<sup>6</sup>

We do business in more than half the states in the union, and they too must cope with economic conditions beyond their control. Usually we see in these states a fitting correlation between economic conditions and government action. Montana is an exception. It seems unwilling to adapt to changing conditions and instead aggravates a difficult economic environment by retaining and instituting laws which victimize its people and its business. Montana sometimes appears caught in a death spiral of economic misfortune impelled by thoughtless public policy.

Richard Bressler, Chairman, Burlington Northern, Inc. December 20, 1985,<sup>7</sup>

---

<sup>6</sup> "BN says state not to blame", by Charles S. Johnson, Great Falls Tribune, November 6, 1985.

<sup>7</sup> "Montana business climate blasted by BN, Inc. chief", Great Falls Tribune, December 20, 1985.

Over the past four years, BN saved over \$20 million in property taxes in Montana and still eliminated over 3,000 jobs here. I am not convinced that they will be any more responsive to Montana than before, but if they are, I am positive that we can work together.

Montana State Senate President Dr. Bill Norman, November 14, 1985,<sup>8</sup>

Burlington Northern is not going to trust Governor Ted Schwinden and it won't trust the state of Montana and current make-up of the Legislature.

Montana State Representative Jack Ramirez, November 14, 1985,<sup>9</sup>

I think the Governor's done the best that anyone could do to try and reach a level of tax that BN will pay without protesting and going to court.

Montana State Senator Fred Van Valkenburg March 26, 1986,<sup>10</sup>

To give up that much revenue is wrong and it is not a settlement, it is a giveaway.

Montana State Senator Thomas E. Towe, March 27, 1986,<sup>11</sup>

The above quotations significantly understated the frustration and despair that most members of the 49th Legislature felt in trying to develop a solution to the issue of Burlington Northern Railroad property taxation. The state's major newspapers were divided in their editorial opinions on the issue; the same was reflected in letters to the editors of the major newspapers.

In an effort to address the controversy, the governor publicly pledged to work toward a settlement with BN that would provide a tax burden for the railroad commensurate with other utilities, and at the same time preclude tax protests and litigation by BN. The proposal was first related in newspaper articles, but without details. The proposal was further outlined in a formal presentation to the Revenue

---

<sup>8</sup> "Senate president favors property tax cut for BN", Great Falls Tribune, November 14, 1985.

<sup>9</sup> "Special BN tax session urged", Great Falls Tribune, November 14, 1985.

<sup>10</sup> "Tough sledding seen for BN plan", by Charles S. Johnson, Great Falls Tribune, March 26, 1986.

<sup>11</sup> "BN attorneys push tax pact with threat of lawsuit", Great Falls Tribune, March 27, 1986.

Oversight Committee on February 21, 1986, by the governor's executive assistant, but details were still lacking.

For the ensuing two months, no specifics were given by the governor's office or Burlington Northern. However, news reports in the Great Falls Tribune provided legislative staff enough information on which to base some analysis. It was that early analysis that allowed the legislature its first glimpse of the proposal's details, including its fiscal implications.

The following is a revised version of a report prepared for the Revenue Oversight Committee and the Legislature immediately prior to the convening of the Second Special Session of the 49th Legislature (March 1986).

## **BACKGROUND**

At the February 21, 1986, meeting of the legislative Revenue Oversight Committee, Teresa Cohea, representing the Governor, informed the Committee that the Governor would include a discussion of the tax rate applicable to railroads and airlines in the call for a special legislative session.

The Governor's intent in including a discussion of the tax rate in the special session call was focused in three main points, (quoting from Ms. Cohea's statement):

1. To return to the tax level proposed by this committee in SB 48 [1985] for railroads and airlines.
2. To avoid potential litigation and insure that the local governments and school districts receive their tax revenue.
3. To establish a tax rate fair to other Montana taxpayers, fair for railroads and airlines, and a rate in compliance with the federal 4-R Act.

Responding to questions from ROC members, Ms. Cohea stated that a tax rate comparable to other utilities was the rate most likely to be proposed, a tax rate of about 12%.

In the March 14, 1986 edition of the Great Falls Tribune, Ms. Cohea was paraphrased as saying,

Under the agreements, the state would gradually lower its [BN's] property tax rates from 14 percent to 12 percent over the next five years. In return, the railroads and airlines would agree not to challenge their taxes for the next six years.<sup>12</sup>

The Tribune article outlined the proposal as having the Burlington Northern Railroad (BN) paying \$10.6 million in property taxes in 1986 and increasing its tax payment by \$300,000 each year through tax year 1991. BN taxes for the 6 years covering the agreement would have been: \$10.6 million in 1986; \$10.9 million in 1987; \$11.2 million in 1988; \$11.5 million in 1989; \$11.8 million in 1990; and \$12.1 million in 1991. The total amount of increase between 1986 and 1991 would have been \$1.5 million.

In comparison to these figures, BN paid property taxes in past years in the following amounts:

**TABLE 1**  
**Selected Historical Data on Burlington Northern Railroad**

| <u>Year</u> | <u>Tax Paid</u> |
|-------------|-----------------|
| 1976        | \$5,666,303     |
| 1977        | 6,230,267       |
| 1978        | 6,249,736       |
| 1979        | 4,368,844       |
| 1980        | 3,994,556       |
| 1981        | 4,627,094       |
| 1982        | 4,351,623       |
| 1983        | 5,265,589       |
| 1984        | 8,170,262       |
| 1985        | 8,787,780       |
| =====       |                 |

---

<sup>12</sup> [Charles S. Johnson, "Accord on Taxes Reached", Great Falls Tribune, Great Falls, Montana, March 14, 1986.] Note: Two days prior to the formal announcement published in the Tribune article, Mr. Leo Berry, a Helena attorney whose law firm represents BN from time to time in legislative and tax matters, called Legislative Council staff with substantially the same information as was reported in the article. In addition to the information, Mr. Berry also said that \$10.6 million was a "base" figure, and implied that while incremental \$300,000 annual increases represented a "phasing-in" of an ICC required accounting change and therefore more or less a commitment by BN to recognize the ICC requirement, the \$10.6 million was a "base" (founded on some value which was not identified) and therefore subject to change.

The subject of this chapter is an analysis of the Governor's proposal for BN taxes as that proposal was outlined in the Tribune<sup>13</sup> and later corroborated by Burlington Northern representatives.

## AS A BASIS FOR DISCUSSION

In order to entertain a discussion of BN property taxation, it was necessary to begin from a finite starting point.

For the purposes of discussion, several assumptions were made in preparing this report and are maintained throughout, unless otherwise noted. Those assumptions were:

1. That the 1985 unit value for BN calculated by the DOR was \$3,462,076,877, and that this value was the true market value of BN's railroad property in the United States.
2. That BN's operations in Montana in 1985 accounted for 14.13% of BN's entire operations in the United States. (This is the allocation factor.)
3. That value of BN's property in Montana in 1985 amounted to \$489,191,462.
4. That the value of BN's Montana property was reduced by 51.8% due to an out-of-court settlement reached by BN and the DOR in 1983.
5. That the statutory tax rate applicable to BN's Montana property in 1985 was 15%.
6. That under the Governor's proposal, the tax rate applicable to BN's Montana property would have been 12%.
7. That under then current law (HB 240 as adopted), the tax rate applicable to BN would have been 14.4% for tax year 1986.
8. That BN paid \$8,787,780 in property taxes in 1985 on its property in Montana.
9. That the average mill levy applied to BN's Montana property in 1985 was 248.417 mills.

---

<sup>13</sup> Charles S. Johnson, "Accord on Taxes Reached", Great Falls Tribune, Great Falls, Montana, March 14, 1986.

## UNDER THE GOVERNOR'S PROPOSAL

### Calculating BN's Unit Value

Under the Governor's proposal as outlined, BN's tax bill was known for 1986 through 1991. Using the tax amount for those years and holding everything else constant, i.e., *ceteris paribus*, the true market value of BN's property in the United States and in Montana could be derived for 1986 through 1991.

That was accomplished by dividing the amount of tax (\$10.6 million) by the average mill levy (248.417 mills). The resulting value was the taxable value of BN's property for the given year (\$42,670,187).

The true market value of BN's property in Montana (\$355,584,897) was found by dividing the taxable value (\$42,670,187) by the tax rate (12%).

The true market value (\$355,584,897) divided by Montana's portion of BN's unit value (14.13%) resulted in the value of all of BN's property in the United States (\$2,516,524,394).

An example of these calculations using BN's 1986 tax bill of \$10,600,000 is provided below.

**EXAMPLE 1:** BN's unit value for 1986 based on a 1986 tax bill of \$10,600,000, 1985 allocation factor and mill levy, and a tax rate of 12%.

$$\$2,516,524,394 = \$10,600,000 \div .248417 \div 0.12 \div 0.1413$$

| Unit Value | 1986 Tax | Mill Levy | Tax Rate | Allocation Factor |
|------------|----------|-----------|----------|-------------------|
|------------|----------|-----------|----------|-------------------|

The information in Table 2 was calculated for BN for 1986 through 1991 using the method illustrated in Example 1.

TABLE 2  
Calculations for BN's Unit Value for 1986 - 1991  
Using the Governor's BN Tax Proposal

| YEAR  | UNIT<br>VALUE   | ALLOCATED<br>VALUE | TAXABLE<br>VALUE AT<br>12% RATE | PROPERTY<br>TAX PAID |
|-------|-----------------|--------------------|---------------------------------|----------------------|
| 1986  | \$2,516,524,394 | \$355,584,897      | \$42,670,188                    | \$10,600,000         |
| 1987  | 2,587,746,783   | 365,648,620        | 43,877,834                      | 10,900,000           |
| 1988  | 2,658,969,171   | 375,712,344        | 45,085,481                      | 11,200,000           |
| 1989  | 2,730,191,560   | 385,776,067        | 46,293,128                      | 11,500,000           |
| 1990  | 2,801,413,948   | 395,839,791        | 47,500,775                      | 11,800,000           |
| 1991  | 2,872,636,337   | 405,903,514        | 48,708,422                      | 12,100,000           |
| AVG   | \$2,694,580,365 | \$380,744,206      | \$45,689,305                    | \$11,350,000         |
| ===== |                 |                    |                                 |                      |

SOURCES: "Property tax paid" from Great Falls Tribune, 3/14/86. Legislative Council estimates.

Assumptions:

Allocation Factor of 14.13%

1985 Average Mill Levy of 248.417 mills

Amount of tax from 3/14/86 Tribune article

Tax rate of 12%

\* The unit value is variable and dependent

The information in Table 3 was calculated for BN for 1986 through 1991 using the method illustrated in Example 1, but using a tax rate of 14.4%. The 14.4% rate was the rate calculated by the DOR after the adoption of HB 240.

TABLE 3

Calculations for BN's Unit Value for 1986 - 1991 Using  
the Governor's BN Tax Proposal and a 14.4% Tax Rate

| YEAR | UNIT<br>VALUE   | ALLOCATED<br>VALUE | TAXABLE<br>VALUE AT<br>14.4% RATE | PROPERTY<br>TAX PAID |
|------|-----------------|--------------------|-----------------------------------|----------------------|
| 1986 | \$2,097,103,662 | \$296,320,747      | \$42,670,188                      | \$10,600,000         |
| 1987 | 2,156,455,652   | 304,707,184        | 43,877,834                        | 10,900,000           |
| 1988 | 2,215,807,643   | 313,093,620        | 45,085,481                        | 11,200,000           |
| 1989 | 2,275,159,633   | 321,480,056        | 46,293,128                        | 11,500,000           |
| 1990 | 2,334,511,624   | 329,866,492        | 47,500,775                        | 11,800,000           |
| 1991 | 2,393,863,614   | 338,252,929        | 48,708,422                        | 12,100,000           |
| AVG  | \$2,245,483,638 | \$317,286,838      | \$45,689,305                      | \$11,350,000         |

SOURCES: "Property tax paid" from Great Falls Tribune, 3/14/86. Legislative Council estimates.

Assumptions:

Allocation Factor of 14.13%

1985 Average Mill Levy of 248.417 mills

Amount of tax from 3/14/86 Tribune article

Tax rate of 14.4% (HB 240)

\* The unit value is variable and dependent

### Calculating BN's Tax Rate

#### Assumption 1: Using BN's 1985 Unit Value

According to the Governor's proposal, the tax rate to be applied to BN should have been 12%. Using a method similar to that used in Example 1, a more accurate calculation of the real tax rate was determined.

**EXAMPLE 2:** BN's tax rate for 1986 based on a 1986 tax bill of \$10,600,000, and 1985 allocated value and mill levy.

$$8.72\% = \$10,600,000 \div .248417 \div \$489,191,462$$

|      |          |      |            |
|------|----------|------|------------|
| Tax  | 1986 Tax | Mill | BN's Value |
| Rate |          | Levy | in Montana |

The tax rate information in Table 4 was calculated for BN for 1986 through 1991 using the method illustrated in Example 2. Assumptions were the 1985 mill levy and allocated value for BN, and the proposed tax amounts.

**TABLE 4**  
**Calculations for BN's Tax Rate for 1986 - 1991**  
**Using the Governor's Tax Amounts and 1985 Values**  
**and Levy**

| YEAR | UNIT<br>VALUE   | ALLOCATED<br>VALUE | APFX<br>TAX<br>RATE | TAXABLE<br>VALUE | AVERAGE<br>MILL<br>LEVY | PROPERTY<br>TAX PAID |
|------|-----------------|--------------------|---------------------|------------------|-------------------------|----------------------|
| 1985 | \$3,462,077,000 | \$489,191,000      | 15.00%              | \$35,368,509     | 248.417                 | \$8,787,780          |
| 1986 | \$3,462,077,000 | \$489,191,000      | 8.72%               | \$42,670,188     | 248.417                 | \$10,600,000         |
| 1987 | 3,462,077,000   | 489,191,000        | 8.97%               | 43,877,834       | 248.417                 | 10,900,000           |
| 1988 | 3,462,077,000   | 489,191,000        | 9.22%               | 45,085,481       | 248.417                 | 11,200,000           |
| 1989 | 3,462,077,000   | 489,191,000        | 9.46%               | 46,293,128       | 248.417                 | 11,500,000           |
| 1990 | 3,462,077,000   | 489,191,000        | 9.71%               | 47,500,775       | 248.417                 | 11,800,000           |
| 1991 | 3,462,077,000   | 489,191,000        | 9.96%               | 48,708,422       | 248.417                 | 12,100,000           |
| AVG  | \$3,462,077,000 | \$489,191,000      | 9.34%               | \$45,689,305     | 248.417                 | \$11,350,000         |

SOURCES: "Property tax paid" from Great Falls Tribune, 3/14/86. Legislative Council estimates.

**Assumptions:**

Allocation Factor of 14.13%

1985 Average Mill Levy of 248.417 mills

Amount of tax from 3/14/86 Tribune article

Unit value held constant at 1985 level

\* The actual tax rate is variable and dependent

**Assumption 2: BN's 1986 Estimated Unit Value**

Prior to the Governor's BN tax proposal being negotiated, the DOR estimated that BN's unit value for 1986 would be about \$4.2 billion. Several factors account for the expected increase, especially an accounting change required by the federal Interstate Commerce Commission (ICC) and lower interest rates.

The tax rate information provided in Table 5 was calculated using the method illustrated in Example 2, the estimated \$4.2 billion unit value for BN, the amounts of tax under the Governor's proposal, and the 1985 average mill levy.

**TABLE 5**  
Calculations for BN's Tax Rate for 1986 - 1991  
Using the Governor's Tax Amounts, 1986 Estimated Values,  
and the 1985 Average Mill Levy

| YEAR | UNIT<br>VALUE   | APPROX             |             | TAXABLE<br>VALUE | AVERAGE<br>MILL<br>LEVY | PROPERTY<br>TAX PAID |
|------|-----------------|--------------------|-------------|------------------|-------------------------|----------------------|
|      |                 | ALLOCATED<br>VALUE | TAX<br>RATE |                  |                         |                      |
| 1985 | \$3,462,077,000 | \$489,191,000      | 15.00%      | \$35,368,509     | 248.417                 | \$8,787,780          |
| 1986 | \$4,200,000,000 | \$593,460,000      | 7.19%       | \$42,670,188     | 248.417                 | \$10,600,000         |
| 1987 | 4,200,000,000   | 593,460,000        | 7.39%       | 43,877,834       | 248.417                 | 10,900,000           |
| 1988 | 4,200,000,000   | 593,460,000        | 7.60%       | 45,085,481       | 248.417                 | 11,200,000           |
| 1989 | 4,200,000,000   | 593,460,000        | 7.80%       | 46,293,128       | 248.417                 | 11,500,000           |
| 1990 | 4,200,000,000   | 593,460,000        | 8.00%       | 47,500,775       | 248.417                 | 11,800,000           |
| 1991 | 4,200,000,000   | 593,460,000        | 8.21%       | 48,708,422       | 248.417                 | 12,100,000           |
| AVG  | \$4,200,000,000 | \$593,460,000      | 7.70%       | \$45,689,305     | 248.417                 | \$11,350,000         |

SOURCES: "Property tax paid" from Great Falls Tribune, 3/14/86. \$4.2 billion unit value is DOR estimate for 1986. Legislative Council estimates.

**Assumptions:**

Allocation Factor of 14.13%

1985 Average Mill Levy of 248.417 mills

Amount of tax from 3/14/86 Tribune article

\* Unit value set at 1986 level

\* The actual tax rate is variable and dependent

**Assumption 3: Allowing for Growth & Appreciation**

Between 1976 and 1985, BN's unit value grew from \$1.174 billion to \$3.462 billion according to DOR appraisal experts. The average annual increase in BN's system value was 15.5% over that 10-year period. (See Table A in Appendix A.)

Early estimates of BN's 1986 unit value indicated a value of \$4.2 billion, an increase of about 17.6% from 1985 to 1986, certainly not an extraordinary increase given historical patterns.<sup>14</sup>

### **Estimating Revenue Implications**

Estimating the revenue implications of the Governor's proposal was done based on some assumptions made by Legislative Council staff. Those assumptions centered on questions of valuation, questions of the tax rate, questions of allocation, and questions of mill levies.

Simply for convenience, the following tables assumed that Montana's share of BN's economic activity (and hence of the unit value) would remain at 14.13%. It is also assumed that the average mill levy applied to BN's Montana property in 1985 of 248.417 would remain constant.

The variables in Tables 6 through 9 were BN's unit value and the tax rate.

---

<sup>14</sup> For the interested reader, several growth assumptions ranging from full historic average growth to 10% of full historic average growth were explored in Table B through Table D in Appendix A. For the more skeptical but still interested reader, similar growth assumptions were applied in Appendix A, Table E through Table H, to BN's 1985 unit value. The range again spans full historic average growth to 10% of growth.

TABLE 6

THE REVENUE IMPLICATIONS OF  
A 12 PERCENT TAX RATE, THE GOVERNOR'S PROPOSAL  
AND DOR'S 1985 UNIT VALUE

| YEAR            | UNIT<br>VALUE   | ALLOCATED<br>VALUE | TAX<br>RATE | TAXABLE<br>VALUE | MILL<br>LEVY | TAX<br>PAYABLE | GOVERNORS<br>TAX<br>PAYABLE | ESTIMATED<br>LOSS |
|-----------------|-----------------|--------------------|-------------|------------------|--------------|----------------|-----------------------------|-------------------|
| 1985            | \$3,462,077,000 | \$489,191,000      | 15.00%      | \$35,368,509     | 248.417      | \$8,787,780    | NA                          | NA                |
| 1986            | \$3,462,077,000 | \$489,191,000      | 12.00%      | \$58,702,920     | 248.417      | \$14,582,803   | \$10,600,000                | \$3,982,803       |
| 1987            | \$3,462,077,000 | \$489,191,000      | 12.00%      | \$58,702,920     | 248.417      | \$14,582,803   | \$10,900,000                | \$3,682,803       |
| 1988            | \$3,462,077,000 | \$489,191,000      | 12.00%      | \$58,702,920     | 248.417      | \$14,582,803   | \$11,200,000                | \$3,382,803       |
| 1989            | \$3,462,077,000 | \$489,191,000      | 12.00%      | \$58,702,920     | 248.417      | \$14,582,803   | \$11,500,000                | \$3,082,803       |
| 1990            | \$3,462,077,000 | \$489,191,000      | 12.00%      | \$58,702,920     | 248.417      | \$14,582,803   | \$11,800,000                | \$2,782,803       |
| 1991            | \$3,462,077,000 | \$489,191,000      | 12.00%      | \$58,702,920     | 248.417      | \$14,582,803   | \$12,100,000                | \$2,482,803       |
| AVG             | \$3,462,077,000 | \$489,191,000      | 12.00%      | \$58,702,920     | 248.417      | \$87,496,820   | NA                          | NA                |
| ESTIMATED TOTAL |                 |                    |             |                  |              |                | \$68,100,000                | \$19,396,820      |

SOURCES: "Property tax paid" from Great Falls Tribune, 3/14/86. \$4.2 billion unit value is DOR estimate for 1986.

Council estimates.

Assumptions:

Allocation Factor of 14.13%  
1985 Average Mill Levy of 248.417 mills  
Amount of tax from 3/14/86 Tribune article  
The tax rate remains constant at 12%  
The unit value is constant at 1985 level  
\* The amount of tax loss is variable and dependent

Legislative

TABLE 7

THE REVENUE IMPLICATIONS OF  
A 14.4 PERCENT TAX RATE, THE GOVERNOR'S PROPOSAL,  
AND DOR'S 1985 UNIT VALUE

| YEAR            | UNIT<br>VALUE   | ALLOCATED<br>VALUE | TAX<br>RATE | TAXABLE<br>VALUE | MILL<br>LEVY | TAX<br>PAYABLE | GOVERNORS<br>TAX<br>PAYABLE | ESTIMATED<br>LOSS |
|-----------------|-----------------|--------------------|-------------|------------------|--------------|----------------|-----------------------------|-------------------|
| 1985            | \$3,462,077,000 | \$489,191,000      | 15.00%      | \$35,368,509     | 248.417      | \$8,787,780    | NA                          | NA                |
| 1986            | \$3,462,077,000 | \$489,191,000      | 14.40%      | \$70,443,504     | 248.417      | \$17,499,364   | \$10,600,000                | \$6,899,364       |
| 1987            | \$3,462,077,000 | \$489,191,000      | 14.40%      | \$70,443,504     | 248.417      | \$17,499,364   | 10,500,000                  | \$6,999,364       |
| 1988            | \$3,462,077,000 | \$489,191,000      | 14.40%      | \$70,443,504     | 248.417      | \$17,499,364   | 11,200,000                  | \$6,299,364       |
| 1989            | \$3,462,077,000 | \$489,191,000      | 14.40%      | \$70,443,504     | 248.417      | \$17,499,364   | 11,500,000                  | \$3,999,364       |
| 1990            | \$3,462,077,000 | \$489,191,000      | 14.40%      | \$70,443,504     | 248.417      | \$17,499,364   | 11,800,000                  | \$3,699,364       |
| 1991            | \$3,462,077,000 | \$489,191,000      | 14.40%      | \$70,443,504     | 248.417      | \$17,499,364   | 12,100,000                  | \$5,399,364       |
| AVG             | \$3,462,077,000 | \$489,191,000      | 14.40%      | \$70,443,504     | 248.417      | \$104,996,184  | NA                          | NA                |
| ESTIMATED TOTAL |                 |                    |             |                  |              | \$104,996,184  | \$68,100,000                | \$36,896,184      |

SOURCES: "Property tax paid" from Great Falls Tribune, 3/14/86. \$3.462 billion unit value is DOR actual for 1986.  
Legislative Council estimates.

Assumptions:

- Allocation Factor of 14.13%
- 1985 Average Mill Levy of 248.417 mills
- Amount of tax from 3/14/86 Tribune article
- The tax rate remains constant at 14.4%
- The unit value is constant at 1985 level
- \* The amount of tax loss is variable and dependent

TABLE 8  
THE REVENUE IMPLICATIONS OF  
A 12 PERCENT TAX RATE, THE GOVERNOR'S PROPOSAL  
AND DOR'S ESTIMATED 1986 UNIT VALUE

| YEAR | UNIT<br>VALUE   | ALLOCATED<br>VALUE | TAX<br>RATE | TAXABLE<br>VALUE | MILL<br>LEVY | TAX<br>PAYABLE | GOVERNORS<br>TAX<br>PAYABLE | ESTIMATED<br>LOSS |
|------|-----------------|--------------------|-------------|------------------|--------------|----------------|-----------------------------|-------------------|
| 1985 | \$3,462,077,000 | \$489,191,000      | 15.00%      | \$35,368,509     | 248.417      | \$8,787,780    | NA                          | NA                |
| 1986 | \$4,200,000,000 | \$593,460,000      | 12.00%      | \$71,215,200     | 248.417      | \$17,691,066   | \$10,600,000                | \$7,091,066       |
| 1987 | \$4,200,000,000 | \$593,460,000      | 12.00%      | \$71,215,200     | 248.417      | \$17,691,066   | 10,900,000                  | \$6,791,066       |
| 1988 | \$4,200,000,000 | \$593,460,000      | 12.00%      | \$71,215,200     | 248.417      | \$17,691,066   | 11,200,000                  | \$6,491,066       |
| 1989 | \$4,200,000,000 | \$593,460,000      | 12.00%      | \$71,215,200     | 248.417      | \$17,691,066   | 11,500,000                  | \$6,191,066       |
| 1990 | \$4,200,000,000 | \$593,460,000      | 12.00%      | \$71,215,200     | 248.417      | \$17,691,066   | 11,800,000                  | \$5,891,066       |
| 1991 | \$4,200,000,000 | \$593,460,000      | 12.00%      | \$71,215,200     | 248.417      | \$17,691,066   | 12,100,000                  | \$5,591,066       |
| AVG  | \$4,200,000,000 | \$593,460,000      | 12.00%      | \$71,215,200     | 248.417      | NA             | NA                          | NA                |

SOURCES: "Property tax paid" from Great Falls Tribune, 3/14/86. \$4.2 billion unit value is DOR estimate for 1986.  
Legislative Council estimates.

Assumptions:  
Allocation Factor of 14.13%  
1985 Average Mill Levy of 248.417 mills  
Amount of tax from 3/14/86 Tribune article  
The tax rate remains constant at 12%  
The unit value is constant at DOR's estimated 1986 level  
\* The amount of tax loss is variable and dependent

TABLE 9

THE REVENUE IMPLICATIONS OF  
A 14.4 PERCENT TAX RATE, THE GOVERNOR'S PROPOSAL  
AND DOR'S ESTIMATED 1986 UNIT VALUE

| YEAR            | UNIT<br>VALUE   | ALLOCATED<br>VALUE | TAX<br>RATE | TAXABLE<br>VALUE | MILL<br>LEVY | TAX<br>PAYABLE | GOVERNORS<br>TAX<br>PAYABLE | ESTIMATED<br>LOSS |
|-----------------|-----------------|--------------------|-------------|------------------|--------------|----------------|-----------------------------|-------------------|
| 1985            | \$3,462,077,000 | \$489,191,000      | 15.00%      | \$35,368,509     | 248.417      | \$8,787,780    | NA                          | NA                |
| 1986            | \$4,200,000,000 | \$593,460,000      | 14.40%      | \$85,458,240     | 248.417      | \$21,229,280   | \$10,600,000                | \$10,629,280      |
| 1987            | \$4,200,000,000 | \$593,460,000      | 14.40%      | \$85,458,240     | 248.417      | \$21,229,280   | 10,900,000                  | \$10,329,280      |
| 1988            | \$4,200,000,000 | \$593,460,000      | 14.40%      | \$85,458,240     | 248.417      | \$21,229,280   | 11,200,000                  | \$10,029,280      |
| 1989            | \$4,200,000,000 | \$593,460,000      | 14.40%      | \$85,458,240     | 248.417      | \$21,229,280   | 11,500,000                  | \$9,729,280       |
| 1990            | \$4,200,000,000 | \$593,460,000      | 14.40%      | \$85,458,240     | 248.417      | \$21,229,280   | 11,800,000                  | \$9,429,280       |
| 1991            | \$4,200,000,000 | \$593,460,000      | 14.40%      | \$85,458,240     | 248.417      | \$21,229,280   | 12,100,000                  | \$9,129,280       |
| AVG             | \$4,200,000,000 | \$593,460,000      | 14.40%      | \$85,458,240     | 248.417      | \$127,375,678  | NA                          | NA                |
| ESTIMATED TOTAL |                 |                    |             |                  |              | \$127,375,678  | \$68,100,000                | \$59,275,678      |

SOURCES: "Property tax paid" from Great Falls Tribune, 3/14/86. \$4.2 billion unit value is DOR estimate for 1986.  
Legislative Council estimates.

Assumptions:

- Allocation Factor of 14.13%
- 1985 Average Mill Levy of 248.417 mills
- Amount of tax from 3/14/86 Tribune article
- The tax rate remains constant at 14.4% (HB 240)
- The unit value is constant at DOR's estimated 1986 level
- \* The amount of tax loss is variable and dependent

## IMPLICATIONS OF TAX RATE CHANGES

The implications of tax rate changes were significant. Several different perspectives are examined in the following narrative. The information in Table 10 was the basis for most of the analysis and the estimates interspersed in the narrative.

**TABLE 10**  
**Selected 1985 Data on Burlington Northern Railroad**

|                                                       |                 |
|-------------------------------------------------------|-----------------|
| BN Unit Value . . . . .                               | \$3,462,076,877 |
| BN Allocation Factor . . . . .                        | 14.13%          |
| BN Value in Montana . . . . .                         | \$489,300,000   |
| Equalization Out-of-Court Settlement Factor . . . . . | 0.482           |
| Equalized BN Value in Montana . . . . .               | \$235,845,000   |
| BN Tax Rate . . . . .                                 | 15.0%           |
| BN Taxable Value . . . . .                            | \$35,376,000    |
| Average Mill Levy for BN . . . . .                    | 248.417         |
| Taxes Paid (Actual) . . . . .                         | \$8,788,000     |

=====

SOURCE: Montana Department of Revenue, Property Assessment Division Staff, interview 3/12/86, telephone conversations 11/13/85 and 3/12/86.  
Note: Numbers are rounded.

### Under House Bill 240 as Adopted

Among other things, House Bill 240 (Ch. 743, L. 1985) established a formula for calculating the tax rate to be applied to railroad and airline transportation property. Preliminary indications are that the HB 240 rate will be about 14.4%. Based on that rate and leaving the remainder of current law intact, an estimate of BN's 1986 taxes -- based on 1985 data -- is calculated below.

**TABLE 11**  
**Estimate of Burlington Northern's 1986 Taxes**  
**Assuming HB 240 as Adopted and 1985 Values**

|                                       |                 |
|---------------------------------------|-----------------|
| BN Unit Value. . . . .                | \$3,462,076,877 |
| BN Allocation Factor. . . . .         | 14.13%          |
| BN Value in Montana . . . . .         | \$489,300,000   |
| BN Tax Rate . . . . .                 | 14.4%           |
| BN Taxable Value . . . . .            | \$70,459,200    |
| Average Mill Levy for BN . . . . .    | .248.417        |
| Estimated 1986 Tax Liability. . . . . | \$17,503,000    |

=====

SOURCE: Table 10 and Legislative Council staff estimates.

#### **Under the Governor's Proposal**

Referring back to the presentation made on February 21, 1986, by Teresa Cohea to the ROC regarding the tax rate applicable to Class fifteen property, the Governor's intent was to:

. . . return to the tax level proposed by this committee [ROC] in SB 48 for railroads and airlines.

This could have been interpreted several ways, because "tax level" could include the tax rate, the amount of tax paid, or something else. Below are two interpretations of "tax level" that reflected a change in the tax rate.

#### **Option One**

Under one interpretation of the Governor's preliminary proposal, the tax rate applicable to BN's Montana property would have decreased from the 1985 level of 15% to 12% for at least 1986 and 1987. Given a 12% tax rate, and leaving the remainder of current law intact, an estimate of BN's 1986 taxes -- based on 1985 data -- was calculated below.

**TABLE 12**  
**Estimate of Burlington Northern's 1986 Taxes**  
**Assuming HB 240 as Adopted, 1985 Values, and 12% Rate**

|                                       |                 |
|---------------------------------------|-----------------|
| BN Unit Value. . . . .                | \$3,462,076,877 |
| BN Allocation Factor. . . . .         | 14.13%          |
| BN Value in Montana . . . . .         | \$489,300,000   |
| BN Tax Rate . . . . .                 | 12.0%           |
| BN Taxable Value . . . . .            | \$58,716,000    |
| Average Mill Levy for BN . . . . .    | \$248.417       |
| Estimated 1986 Tax Liability. . . . . | \$14,586,000    |

=====

SOURCE: Table 10 and Legislative Council staff estimates.

Option Two

Under another interpretation of the Governor's preliminary proposal, the tax rate applicable to BN's Montana property would have decreased from the 1985 level of 15% to 11.7% for at least 1986 and 1987. Given an 11.7% tax rate, and leaving the remainder of current law intact, an estimate of BN's 1986 taxes -- based on 1985 data -- was calculated below.

**TABLE 13**  
**Estimate of Burlington Northern's 1986 Taxes**  
**Assuming HB 240 as Adopted, 1985 Values, and 11.7% Rate**

|                                       |                 |
|---------------------------------------|-----------------|
| BN Unit Value. . . . .                | \$3,462,076,877 |
| BN Allocation Factor. . . . .         | 14.13%          |
| BN Value in Montana . . . . .         | \$489,300,000   |
| BN Tax Rate . . . . .                 | 11.7%           |
| BN Taxable Value . . . . .            | \$57,248,100    |
| Average Mill Levy for BN . . . . .    | 248.417         |
| Estimated 1986 Tax Liability. . . . . | \$14,221,000    |

=====

SOURCE: Table 10 and Legislative Council staff estimates.

## Effect on Other Taxpayers

Estimating the impact of adjusting BN's tax rate on Montana's other property taxpayers required several assumptions to be made. As important as any are the levels of the property tax base and property tax revenues.

In 1985, Montana had a statewide property tax base (taxable value) of \$2,370,133,344. Total property taxes collected amounted to \$572,046,937. Dividing the tax paid by the tax base indicates a statewide average levy of 241.135 mills.

Based on the assumptions that collected tax revenues would not change and that no changes would occur in the tax base other than that attributable to the railroads and the tax rate applicable to the railroads, some estimates of the railroad's tax rate were calculated.

Tables 14 through 17 show how Montana's other taxpayers would have been affected by the implementation of HB 240 as adopted, and as might occur under two interpretations of options proposed by the Governor.

TABLE 14

### Selected 1985 Property Tax Data

|                                      |                 |
|--------------------------------------|-----------------|
| Statewide taxable value . . . . .    | \$2,370,133,344 |
| Property tax collections. . . . .    | \$572,046,937   |
| Statewide average mill levy. . . . . | 241.135         |

=====

SOURCE: Governor's Office of Budget and Program Planning, March 13, 1986, and Legislative Council staff estimate.

TABLE 15

### Taxable Values and Mill Levies Under HB 240 as Adopted

|                                              |                 |
|----------------------------------------------|-----------------|
| Statewide taxable value . . . . .            | \$2,405,216,544 |
| Property tax collections. . . . .            | \$572,046,937   |
| Statewide average mill levy. . . . .         | 237.835         |
| Estimated reduction in levy; 85-86 . . . . . | 3.300           |

=====

SOURCE: Governor's Office of Budget and Program Planning, March 13, 1986, and Legislative Council staff estimate.

TABLE 16

**Taxable Values and Mill Levies Under HB 240  
With 12% Rate  
Governor's Option One**

|                                              |                 |
|----------------------------------------------|-----------------|
| Statewide taxable value . . . . .            | \$2,393,473,344 |
| Property tax collections. . . . .            | \$572,046,937   |
| Statewide average mill levy. . . . .         | 239.002         |
| Estimated reduction in levy; 85-86 . . . . . | 2.133           |

=====

SOURCE: Governor's Office of Budget and Program Planning, March 13, 1986, and Legislative Council staff estimate.

TABLE 17

**Taxable Values and Mill Levies Under HB 240  
With 11.7% Rate  
Governor's Option Two**

|                                              |                 |
|----------------------------------------------|-----------------|
| Statewide taxable value . . . . .            | \$2,392,005,444 |
| Property tax collections. . . . .            | \$572,046,937   |
| Statewide average mill levy. . . . .         | 239.149         |
| Estimated reduction in levy; 85-86 . . . . . | 1.986           |

=====

SOURCE: Governor's Office of Budget and Program Planning, March 13, 1986, and Legislative Council staff estimate.

## **SUMMARY AND CONCLUSION**

The taxation of railroads is a complex process. It involves governmental agencies at the state and local level and, with the adoption of the 4-R Act, the federal level.

With the passage and approval of HB 240 during the 1985 regular session, the tax rate applicable to railroads was expected to be at about 14.4% for tax year 1986. A rate of 14.4% was relatively close to Montana's longstanding statutory rate for railroads of 15%.

Regardless of the degree of change in the tax rate applied to railroads' property or in the amount of value attributable to the railroads, the amount of tax paid by the railroads affects the amount of tax paid by every other Montana property taxpayer.

- If the railroads pay more tax in one year than in another, Montana's residential property owners and main street business people will pay less. Conversely, if railroads pay less tax in one year than in another, Montana's other taxpayers will pay more.

The policy decision to be addressed by every Legislature, and to some degree by the Governor, is: How much tax should the railroads and airlines pay in Montana? Like all questions of tax policy, the response will affect every other taxpayer in Montana.

The decision facing Montana's legislatures in setting the level of taxation for Class fifteen property -- or any other class of property -- is, unequivocally, a difficult one.<sup>15</sup> It must be based on sound information and made with confidence that equity will be ensured. In the case of Class fifteen property, it must also be within federal legislative boundaries.

Montana's system of property taxation allows the legislature to meet all of the tests, including equity and legality. It is, within federal limitations, the

---

<sup>15</sup> Montana has faced other decisions in the past that have been just as difficult or possibly more so. A January 1986 article in the Wall Street Journal recounted some earlier Montana history which traces a close parallel to the situation that faced the legislature in March 1986. In a discussion of Montana's attitudes toward business and the issue of BN taxation, the writer looked backward for comparison.

Long-time observers of the Montana scene, however, say it would be surprising if Montana were able to block out the past. In addition to sharing the West's traditional antipathy to big railroads, Montanans are well aware of the state's legacy of economic and political dominance by the old Anaconda Co. . . .

But in 1903, local historians recall, that copper-mining concern and its holding company asked the state to call a special session and pass a "fair trials" law allowing for a change of venue in court cases if the company felt a judge was prejudiced against it.

When Montana resisted, the company announced a shutdown of all operations, and in a few days 80% of the workers of Montana were out of work with winter setting in. Shortly afterward, the Montana governor called a special legislative session, which passed the law Anaconda wanted.

Gov. Schwinden, however, maintains that such stories are no longer anything but historical anecdotes. "An overwhelming number of people recognize that times have changed," he said. (Wall Street Journal, "Burlington Northern Feels a Chill In Montana As Tax Dispute Sets Off Business-Climate Debate", by Ken Slocum, January 27, 1986, p. 18.)

legislature's prerogative to require full valuation and set the appropriate level of taxation. Without such control, the system will degenerate to a point where only inequities are assured. It is essential to protect the system with guarantees of standard, professional appraisal practices and with legislative control of tax rates.

While the Revenue Oversight Committee and past Legislatures as a whole have been repeatedly reminded that full and true assessments and legislative control of tax rates are the only means to a workable property tax system, the message simply cannot be overemphasized.

While somewhat lengthy, the following passages support past admonishments.

Assessment and classification of property for property taxation have been problems for the Montana legislature since 1864, when the first territorial legislature authorized a levy of four mills on the assessed value of taxable property.

Although "taxable property" under the 1864 statute included almost all property except mining claims, the amount of tax revenue produced was not as great as the pioneer legislators had hoped. Governor Smith reported to the second legislative assembly that less than 30% of the total property tax due had been collected. Three counties -- Meagher, Beaverhead, and Chouteau -- collected no property taxes at all, and other counties taxed at "ridiculously low" assessments, far below the market value of property.

In the 1867, 1869, and 1872 assemblies, the territorial legislature attempted to improve collections by changing the assessment date and lowering the mill levy to two mills on the dollar, but underassessment continued. . . .

Early legislators quickly learned a perennial truth of property taxation: the gap between assessed value and market value widens each year instead of narrowing. Despite the fact that statutes required all property to be assessed and taxed at "full cash value", a system of fractional assessments, or assessment at some percentage of full value, reigned. In 1880 the federal government computed that Montana had a ratio of 64.7% of assessed value to market value; in 1917, a Montana tax commission showed that the ratio had dropped below 50% for almost all property and as low as 18% for some types.

. . . The general property tax system has been called "thoroughly American" because it attempted to translate the ideal of "frontier democracy" into monetary terms by making all property-holders bear proportional shares in the cost of government. Legislators discovered, however, that the general property tax system was undermined by a human rather than American trait: the desire to avoid taxes by any means. . . .

The dangers of Montana's extralegal fractional assessment have long been recognized. In 1954, the State Board of Equalization noted that the classification law:

. . . is necessarily anchored to the full cash value provisions of section 84-401 [RCM], and when we deliberately cut loose from that anchor we began to drift. The administration of the law has so deteriorated over the years that we now have . . . a classification law within a classification law.

In 1960, the Montana Supreme Court stated that assessors are forced to maintain a "legal fiction of full valuation in the face of contrary facts." The 1963 Special Committee on Classification and Appraisal commented on the "make believe" and "pretense" of retaining statutes requiring assessment at full value and called the system whereby assessment ratios were set outside the legislature "entirely unacceptable". The Montana Fiscal Affairs Study in 1970 noted that the system of fractional assessment makes "it difficult for a taxpayer to comprehend the operations of the property tax." Witnesses testifying before the 1972 hearing of the Subcommittee on Intergovernmental Relations on Montana's property taxes declared that "by not assessing all classes of property at its true and full value or the same percentage thereof -- if a percentage is used -- we have and are destroying the design and effect of the classification law. . . . (Montana's Property Taxes: Assessment and Classification, by Teresa Olcott Cohea, Montana Legislative Council, Helena, Montana, December 1978, pp. 7-10.)

Ms. Cohea's findings and conclusions are every bit as true and important today as they were in 1978. They were written when the legislature was facing the same kind of decisions that the legislature faced in early 1986 (and still faces). In writing for her committee, Ms. Cohea further stated:

The Subcommittee [on Taxation] established 100% of market value as the basis of assessment for all property. . . . The Subcommittee chose market value as the basis of assessment for two reasons:

(1) Market value is one of the few concepts of value with a concrete meaning, understood by all persons who buy and sell goods. Terms like "true and full value", "full and fair cash value", or "actual value" -- used as the statutory basis of assessment in other states -- do not have any intrinsic meaning and must be defined in terms of market value or some other term of general consensus.

(2) Market value can be readily determined for most types of property. . . . Inheritance tax, for example, is imposed on the "fair market value of the property as of the date of the decedent's death". Fair market value is defined in MAC rules as

. . . the amount in terms of money which a property will bring as exposed for sale in the open market allowing the period of time typical for the particular type of property involved and under conditions where

both parties to the transaction are under no undue compulsion to sell or to buy and are able, willing and reasonably well informed. (Cohea, p. 18.)

What the Subcommittee that Ms. Cohea was writing for was trying to do was establish equity and legislative control in Montana's property tax system. This was to be accomplished through full valuation by professional appraisers and control of the tax rate by the legislature. In legislation recommended by the Subcommittee, Ms. Cohea analyzed that,

. . . the assessment rate and the tax rate for all property would be set in statute and directly controlled by the legislature. . . (Cohea, p. 19.)

Regardless of arguments over potential revenue losses or gains, debates over the advisability of inclusion or exclusion of some types of property in the definition of "commercial and industrial", or the prospects of short-term or long-term health of the railroad industry, Montana's legislature has an opportunity -- if not a responsibility -- to protect the integrity of the property tax system.

If the policy decision is made to tax Class fifteen or any other class of property at a certain level, the mechanism by which the decision must be effected is the tax rate. This is true even if, because of federal law or otherwise, the property receives certain protection against discriminatory assessment or taxation. It is the tax rate that must be adjusted.

Against all other choices, full market valuation must be protected. To allow anything less is to allow a return to the "pretense", "make believe", and "legal fiction" of "extralegal" fractional assessments.

## EPILOG

The Governor called the 49th Legislature into special session during March of 1986. One of the specific issues to be addressed was the taxation of Burlington Northern Railroad's operating property. Five bills were introduced that were aimed at alleviating the railroad taxation question: Senate Bill Nos. 8, 10, and 11, and House Bill Nos. 15 and 19. The following is a summary of the bills.

#### Senate Bill No. 8

Senator Fred Van Valkenburg, the Senate Majority Leader, was the primary sponsor of Senate Bill No. 8, the Governor's proposal for revising BN's taxes. The proposal would have set the statutory tax rate for railroad operating property at 12% of full market value, the same rate applicable to other types of industrial property and a rate that was within the limitations imposed by the 4-R Act. It would have also statutorily established an "equalization factor" that was to represent a sales/assessment ratio of 70% for tax year 1986, and 75% for tax years 1987 through 1991. The bill died in the Senate Taxation Committee.

#### Senate Bill No. 10

With the controversy over railroad taxation, the issue of property taxes paid under protest was also of concern. Senator Tom Towe, Chairman of the Senate Taxation Committee and a long-time participant in the railroad taxation debate, introduced Senate Bill No. 10. The bill would have allowed the expenditure of a portion of property taxes paid under protest, while the remainder of the protested taxes would be escrowed until the matter at issue was resolved. Although the bill was primarily aimed at the protested taxes of the railroad (and to some degree the high-voltage power lines owned by the Bonneville Power Administration and located in several western Montana counties), its provisions were generally applicable to all property taxes paid under protest. The bill died in committee.

#### Senate Bill No. 11

An interesting twist developed during the March 1986 special session when the state's airlines made a request of the legislature that they be separated from the railroads for property tax purposes. Historically, airlines and railroads had been in the same property tax class.

The rationale for the request was that the airlines did not have the same arguments as the railroads had with the state's practices of assessing and appraising property, or with the way the mandates of the 4-R Act were achieved through the adoption of HB 240 (Ch. 743, Laws of 1985.)

As adopted, SB 11 separated railroads and airlines into two separate classes for property tax purposes, and established the taxable rate for all airlines at 12% of market value. Interestingly, the airlines saw no need for an "equalization factor" as proposed by Burlington Northern and the Governor in Senate Bill No. 8.

Senate Bill No. 11 was adopted and became Ch. 7, Special Laws of Montana, 1986 (March).

#### House Bill No. 15

At the core of the railroad issue before the 49th Legislature in March of 1986 was the tax rate applicable to the Burlington Northern Railroad. The legislature, with the adoption of HB 240 during the regular session, had set the rate at the maximum allowable under the federal 4-R Act, about 14.4% as established by the HB 240 formula. The railroad had contended throughout the debate that the appropriate rate was something less than the 14.4%, and in fact, less than the 12% applicable to other industrial property and the rate agreed to by property similarly protected by federal law, i.e., the airlines.

In an attempt to concentrate on some middle ground and to effect what was thought to be the original intent of the governor's proposal, the chairman of the Revenue Oversight Committee and the Vice-Chairman of the House Taxation Committee, Representative Mel Williams, proposed House Bill No. 15. As introduced, the bill would have established the maximum rate applicable to all Class fifteen property, i.e., railroads and airlines, at the lesser of 12% of market value or the maximum rate allowable under the 4-R Act as the rate was to be determined under the HB 240 provisions. The bill died in the House Taxation Committee.

#### House Bill No. 19

As a further effort at compromise, Representative Ray Peck introduced House Bill No. 19. The bill combined parts of Senate Bill No. 8, i.e., the governor's proposal, and House Bill No. 15 to establish a tax rate the lesser of 12% or the maximum allowable 4-R Act rate, and further allowed an "equalization factor" to be phased in over a 5-year period.

While attempts such as this often lead to an acceptable solution, this effort did not. The bill was taken from the House Taxation Committee, amended on the floor of the House, and transmitted to the Senate. However, the reception for the bill in the Senate was not so warm; it died in the Senate Taxation Committee.

#### House Bill No. 38, Third Special Session

A third special session of the 49th Legislature was called during the week of June 16, 1986. The railroad taxation issue still was at hand, but the waters had calmed some over the preceding 6 weeks.

Representative Williams reintroduced his House Bill No. 15 from the March special session as House Bill No. 38. With considerably less fanfare and controversy, the bill passed the House by a 58-38 margin and the Senate by a 48-2 margin. (See Ch. 24, Special Laws of Montana, 1986 (June)).

#### The 50th Legislature

Taxation of the railroads' operating property was not much of an issue during the 50th Legislature. The only bill addressing the taxation of railroad property as its primary subject was House Bill No. 843, introduced by House Majority Leader Representative Tom Hannah. The bill would have revised the formula established in 1985 in HB 240 by removing oil and mines net proceeds and coal gross proceeds from the statutory definition of "commercial" property. The bill was heard, but died in the House Taxation Committee.

#### **Litigation**

Since the 4-R Act became effective in 1979, the issue of determining the market value of railroads was held to be an issue of state jurisdiction and not reviewable under the 4-R Act. This premise was upheld in 1983 by the Tenth Circuit Court of Appeals in *Burlington Northern R. Co. v. Lennen*, 715 F.2d 494 (1983, cert. den., 467 U.S. 1230 (1984). (See also *Burlington Northern R. Co. v. Bair*, 766 F.2d 1222 (1985).

However, in a 1987 U.S. Supreme Court case, *Burlington Northern R. Co. v. Oklahoma Tax Commission*, \_\_\_\_ U.S. \_\_\_\_ (1987), the Court decided that the 4-R Act

does allow the federal court review of alleged overvaluation of protected property. In writing for a unanimous Court, Justice Marshall wrote:

The Court of Appeals, following its decision in *Burlington Northern R. Co. v. Lennen*, supra, held that district courts may not review claims of discriminatory taxation based upon overvaluation of railroad property unless the plaintiff first makes a preliminary showing of intentional discrimination. Respondents suggest that Sec. 11503 never permits district court review of such claims. Brief of Respondents State Board of Equalization et al. 9; Tr. of Oral Arg. 41, 52-53. Our reading of the statute convinces us that both positions are untenable. (See *The United States Law Week*, April 28, 1987, 55 LW 4583.)

The reversal of the appellate courts in *Lennen* and *Bair* opens the door for additional federal litigation of state assessed values of railroad property. For Montana, the Oklahoma Tax Commission decision portends a return to a situation faced in the early 1980's: a considerable amount of property tax revenue cached away in a protest fund. The state's response, along with its neighbors' responses, will call for a new chapter in the book on the taxation of railroad property.

05077b.wp

## PART TWO

### INTRODUCTION

Similar to a majority of other states, Montana controls the sale of liquor and other spiritous beverages.

Historically, the state has received a considerable amount of revenue from liquor license taxes, liquor excise taxes, and proprietary profit from the sale of liquor. During the late 1970's and 1980's, the nationwide trend of declining consumption, and therefore sales, of alcoholic beverages was also observed in Montana. With declining consumption and sales, the state's liquor revenues began to decline as well.

In late 1985, the Department of Revenue (DOR) informed the Revenue Oversight Committee that profits from liquor sales were on a decline curve that needed to be leveled off or, preferably, reversed. The Committee agreed that the DOR should analyze the decline and present the Committee and the legislature with alternatives.

The DOR responded in January of 1986 with a preliminary report on the decline in liquor profits. The Committee requested a follow-up report to be presented in February.

As a result of the Department's analysis, and due to the budget situation that faced the state in January, 1986, the DOR exercised its prerogative and statutory responsibility by developing a plan for the recovery of the liquor division. The original plan called for the closure of several state stores and state agency stores, the restructuring of liquor prices for some products, and the reduction of expenses in a number of areas.

During the first five months of 1986 the DOR presented to the Revenue Oversight Committee a number of options for dealing with the decline in liquor profits. The following narrative describes the activities of the DOR Liquor Division, the Revenue

Oversight Committee, the 49th Legislature, and others as the issue of Montana's liquor enterprise was examined during the 1985-86 interim.

## CHAPTER FOUR

### Issues Relating to Montana's Liquor Enterprise

#### EARLY DELIBERATIONS

##### November 1985

At the November 15, 1985 meeting of the Revenue Oversight Committee (ROC), Department of Revenue Director John LaFaver informed Committee members that liquor profits had been declining for the past several years and were continuing to decline. He noted that costs associated with the state's liquor enterprise are largely fixed, and without revisions to the liquor operations, profits from declining liquor sales would necessarily continue their decline.

In an effort to achieve the 13% profit goal and the 15% maximum expense level requested by the legislature in the major appropriation bill, Mr. LaFaver outlined several options:<sup>1</sup>

1. Reducing store hours.
2. Establishing greater investment control and reductions in inventory.
3. Establishing new and lower commission schedules for agency stores.
4. Revising the pricing structure to an extent greater than 15% of net sales.
5. Closing some state liquor stores or agency stores.
6. Planning the implementation of a combination of the first five options.

It was estimated that without some action being taken, the state stood to lose about \$1.8 million in liquor profits during the fiscal 86-87 biennium.

---

<sup>1</sup> Minutes of the Revenue Oversight Committee meeting, November 15, 1985, Montana Legislative Council, Room 138, State Capitol, Helena, Montana, 59620.

At the Committee's request, Mr. LaFaver agreed to develop a comprehensive plan that, when implemented, would lead towards recovery of the state's liquor enterprise.

The six options outlined above formed the basis for discussion over the succeeding five months. Several of the options were eliminated, others were revised. Throughout the effort, additional options continued to be explored.

### January 1986

In a report to the Revenue Oversight Committee on January 10, 1986, the DOR stated that the decline in liquor sales amounted to over \$4.2 million.<sup>2</sup> That decline was larger than any decline in Montana's liquor enterprise history, except the decline experienced subsequent to the Montana Wine Initiative in 1980.

Accompanying the dollar decline in sales were commensurate declines in volume and profits. Stated in "constant" 1985 dollars, profits in 1985 were lower than at any time since 1934, the year the state liquor enterprise was established.

In an effort to address the decline in profits, the DOR was prepared to pursue an immediate and direct course of action. The plan was founded on the following rationale stated by the Director:

We begin from the premise that it is not in the public interest to encourage higher alcohol consumption. Since the long-term prospect is a continued decrease in sales of distilled spirits, we must look primarily to a combination of decreased costs and a pricing structure reflective of actual costs to reverse falling profits.<sup>3</sup>

---

<sup>2</sup> "Montana's Liquor System: A Plan For Recovery", memorandum from John D. LaFaver, Director, Montana Department of Revenue, to the Revenue Oversight Committee, January 10, 1986.

<sup>3</sup> Ibid., p. 3.

## **Store Closures**

In a survey of other states in the region, the DOR concluded that Montana, with one liquor outlet for every 5,964 residents, provided far greater convenience than other states. (The next closest state ranking provided one outlet for every 7,196 residents.)<sup>4</sup>

Based partially on that finding, and on the premise that costs should be reduced at a minimum reduction in convenience, the DOR recommended that "at least 10 stores and agencies that operate within 15 miles of other state liquor outlets" be closed. The stores targeted for closure were in the market areas of Billings, Butte, Helena, Great Falls, Kalispell, and Missoula.<sup>5</sup>

## **Price Restructuring**

In January of 1986, all liquor was subjected to a 40% markup, regardless of price or size of container. The effect of the "across the board" markup did not provide for an equitable distribution of profit from all products sold. Consequently, the DOR recommended implementing a multi-tiered pricing concept. In effect, more expensive products would be marked-up less than less expensive products. It was anticipated that changes in retail prices would be concentrated in smaller volume, lower priced products, and the price increases would generally be less than 3%.

## **Inventory Control**

The problem of controlling the state's inventory of liquor items has been recognized for the past several years. In a 1982 report prepared by the Office of the Legislative Auditor, it was noted that the average inventory turnover rate in the state's stores was about four times a year. Discussions with DOR personnel and

---

<sup>4</sup> Ibid., p. 3.

<sup>5</sup> Ibid., p. 3.

officials in other states indicated that a turnover rate of twelve times a year was optimal.<sup>6</sup>

The report also concluded that excess inventory was a significant, although indirect, expense to the state.

A statistical evaluation of [50 liquor items randomly selected from the warehouse inventory list] indicated an excess in the warehouse with a minimum value of \$48,000 as compared to a total inventory of \$3,273,953, or about 1.5 percent. This indicates that the ordering procedures currently used by the department, the Warehouse Requirements Program, adequately controls inventory levels in the warehouse.

The division has unnecessarily invested at least \$608,600 in inventory. As a comparison, if the money had been invested at the average short-term investment pool rate (13.8 percent) for fiscal year 1981-82, \$84,000 in interest could have been earned.<sup>7</sup>

A follow-up audit conducted by the Office of the Legislative Auditor in May of 1986 concluded that the DOR had still not achieved an appropriate inventory level, i.e. that there continued to be excess inventory in the state's stores and agencies.

. . . we found that while in some cases inventory levels have decreased, overall there still appears to be excessive inventories in a majority of stores. . .

A comparison of overall division sales with overall inventory on hand . . . shows the division continues to maintain average liquor inventory levels that are about four times higher than average monthly sales. . . .

Money invested in excess inventories plus the associated storage and handling costs could be used for other purposes or invested to increase state revenues.

. . . inventory level reductions with faster product turnover for an entire year could provide a one-time saving of \$5.2 million that would improve cash flow and generate an additional \$618,000 in income annually by retaining the revenue in the division's revolving fund.

The division has not established a specific goal for inventory levels to be maintained by various state/agency liquor stores. . . . Since most state/agency stores receive at least two deliveries per month, it should be

---

<sup>6</sup> Performance Audit: Department of Revenue Liquor Division, Office of the Legislative Auditor, Room 135, State Capitol, Helena, MT, 59620, December, 1982, p. 14.

<sup>7</sup> Ibid., pp. 12-13.

possible to maintain inventory levels equal to one to one and one-half months of sales.<sup>8</sup>

The DOR's perception of the inventory problem was similar. Mr. LaFaver's report stated that while

. . . significant progress has been made in controlling the size of liquor inventories, particularly at the state warehouse, much work remains. The department intends to impose inventory standards on all outlets by product. . . . While inventory control does not directly improve liquor system profits, it does free more cash for investment and yield more general fund revenue."<sup>9</sup>

In its final recommendation, the DOR proposed to limit the hours of operation for some liquor stores. The DOR's research indicated that sales in some stores simply did not justify a full 8-hour operating day.

The situation was of more import to the DOR than may be appreciated. Not only was the profit margin of the enterprise on a continued decline, but in January, 1986 the governor also ordered a 2% reduction in general fund expenditures in all executive branch agencies. Written on January 10, 1986, the Director's memorandum summarized what the DOR saw as the need for immediate action:

We anticipate implementing the recovery plan on March 1, 1986 and plan to have several of the outlets closed and the revised pricing structure in place by July 1, 1986. Implementation by this date should enable us to meet our legislative profit mandate for Fiscal 1987 even though we will be short for Fiscal 1986.<sup>10</sup>

Discussion of the DOR memorandum at the January 1986 Revenue Oversight Committee meeting revealed some additional information. Overall, the expenses of the DOR Liquor Division were about the same in 1985 as they were in 1965,

---

<sup>8</sup> Follow-up on Previous Performance Audit of the LIQUOR DIVISION: DEPARTMENT OF REVENUE, Office of the Legislative Auditor, Room 135, State Capitol, Helena, MT, 59620, May, 1986, p. 2, passim.

<sup>9</sup> Op. cit., "Montana's Liquor System", p. 4.

<sup>10</sup> Ibid., p. 5.

adjusted for inflation. Similarly, salary and benefit costs were at approximately the same level as the costs were in 1955.<sup>11</sup>

With respect to store closures, members of the ROC were concerned about the effects on state employees, liquor store lessors or owners, and the convenience factor. After repeated questions on potential closures, Mr. LaFaver commented:

To the extent that this is a business, it needs to be dictated by a reasonable profit on the operation we have. If we retain the number of outlets we have now, in two, three, or four years, we won't be making any money at all. We must establish a structure whereby we can assure ourselves, over a period of time, that we are going to the (sic) return money to the state general fund.<sup>12</sup>

With this introductory report and discussion by the Revenue Oversight Committee and the Department, the groundwork was laid for significant revisions in the state's liquor enterprise.

#### February 1986

At the February 21, 1986, meeting of the Revenue Oversight Committee, the Department's plan for liquor division recovery was brought before the public. As might be expected, there was more objection to the the plan than there was support.<sup>13</sup>

Specifically, the Department outlined its proposal to address the declining liquor

---

<sup>11</sup> Op. cit., Minutes, p. 47.

<sup>12</sup> Ibid., p. 55.

<sup>13</sup> See Minutes, Revenue Oversight Committee, February 21, 1986, Montana Legislative Council, Room 138, State Capitol, Helena, Montana, 59620, pp. 17-36, and "Exhibits".

profit issue in a memorandum to the Revenue Oversight Committee.<sup>14</sup> Summarizing the proposal, the Department's strategy was to:

1. Lower administrative costs at the Helena level in the central office by \$25,500.
2. Increase profits in the seven major market areas, aiming for a profit margin increase of 19% with a gross volume of between \$2.5 million and \$3.5 million in sales.
3. Ensure adequate retail and wholesale service by maintaining an alternative store location as short a distance as possible from the store proposed for closure.
4. Reduce store hours by one hour per day.
5. Accelerate the present policy of lowering agency commissions from ten percent to eight percent.
6. Institute a price restructuring by establishing a higher mark-up on low-cost and small-sized products as compared to other higher-cost or larger-sized products.

The seven major market areas in which the DOR proposed store closures were, as might be expected, located in and around the state's major metropolitan areas. Specifically, the DOR recommended closure of the following:

| <u>Store Location</u> | <u>Store Description</u>     |
|-----------------------|------------------------------|
| Kalispell             | Store #195                   |
| Evergreen Agency      | Store #67                    |
| Butte                 | Store #2                     |
| Walkerville           | Agency Store #136            |
| Billings              | Store #5                     |
| Bozeman               | Store #193 (Downtown Store)  |
| Helena                | Store #197 (Northgate Plaza) |
| East Helena           | State Store                  |
| Great Falls           | West Side Store              |
| Missoula              | Store #171 (downtown)        |

---

<sup>14</sup> See "Recovery Plan for the State Liquor Enterprise", from DOR Director John LaFaver to the Revenue Oversight Committee, February 14, 1986, as "Exhibit #8" in Minutes, Revenue Oversight Committee, February 21, 1986, Montana Legislative Council, Room 138, State Capitol, Helena, Montana, 59620.

It was estimated that the closure of the aforementioned 10 stores would result in annual savings of about \$860,000. The reduction in store hours was estimated to save \$302,000 annually, reductions in commissions from 10% to 8% was estimated to save \$190,000, and the price restructuring was estimated to generate an additional \$570,000. With an additional estimated \$25,500 in savings from cost curtailments in the central office, the profit picture was expected to improve about \$1,950,000 under the DOR's plan.

Although the proposal outlined by the Department would ostensibly achieve the stated goals, there was considerable opposition to the plan. At the February 21, 1986, ROC meeting, more than 20 people testified in opposition. Since many (or perhaps most) of those testifying were either store owners, agency lessees, or state employees, their opposition may be adequately explained by their personal involvement in the situation.

The Committee could not ignore the situation that the liquor enterprise was experiencing; neither could it ignore the opposition to the Department's proposal. Consequently, on a motion by Representative Dan Harrington, the Committee unanimously requested the Department to not proceed with the closure of any liquor stores until the issues could be brought before the 1987 Legislature.<sup>15</sup>

### March 1986

With a special session of the legislature having been called for March 24, 1986, for the purpose of dealing with a number of items, the Revenue Oversight Committee again addressed the issue of the state's liquor enterprise.

During the four weeks between ROC meetings, the DOR forged ahead with the implementation of its proposal for liquor store recovery. A scaled-down version of the store closure plan was the first element to be undertaken, with seven (rather than 10) stores being marked for closure. Those stores were in Kalispell, Butte, East Helena, Great Falls, Bozeman, Lolo, and Billings.

---

<sup>15</sup> Ibid., Minutes, February 21, 1986, pp. 34-35.

By the time the ROC met on March 21, 1986, the East Helena store had already been closed, employees notified, the lessee notified, and the liquor inventory removed from the premises.

In his opening comments to the Committee, DOR Director John LaFaver reassessed the situation facing the state, and the DOR's responsibilities in maintaining a statutory profit goal. He continued by explaining the Department's actions of liquor store closures.

At the February [21, 1986] meeting, I attempted to emphasize that while the proposal was not final, the DOR was looking for a recommendation and was committed to a course of action that would restore the liquor business to the desired measure of profitability. I emphasized that the DOR would not stand by idly while liquor profits continued to fall. . . . Two million dollars of revenue can be restored to the general fund during this biennium if the plan is allowed to be carried out.<sup>16</sup>

Understating the Committee's reaction, as representatives of the Legislature the ROC members were not pleased by the Department's action. The displeasure was not necessarily from the perspective that the members thought that the DOR actions were ill-advised in a business sense; the Committee was frustrated that its request of the Department to refrain from liquor store closures until the matter could be addressed by the full legislature had been ignored!<sup>17</sup>

### March 1986 Special Session

What the Revenue Oversight Committee could not accomplish with its February 1986 recommendation on the closure of liquor stores, the 49th Legislature meeting in

---

<sup>16</sup> Minutes, Revenue Oversight Committee, March 21, 1986, Montana Legislative Council, Room 138, State Capitol, Helena, MT, 59620, pp. 21-22.

<sup>17</sup> Referring to the March 21, 1986, ROC Minutes, the following summary of the discussion is telling. "Discussion with John LaFaver centered on the Committee's disappointment that the DOR came to the ROC for a recommendation, and then went ahead with liquor store closures even though the Committee unanimously recommended that the DOR not proceed with the closure of the liquor stores until the 1987 Legislature can discuss the proposal." (Ibid., Minutes, March 21, 1986, p. 22.)

special session did accomplish with the passage of House Bill No. 14. In summary, HB 14:

1. Precluded any liquor store from being closed unless the store:
  - (a) was operating at a loss; or
  - (b) was approved for closure by the Legislature.
2. Precluded the Department of Revenue from changing the commission rate paid to any of the state's agency liquor stores until July 1, 1986.
3. Required the Department to work with the Revenue Oversight Committee to develop a liquor division recovery plan for consideration by the full Legislature in June of 1986.

The bill passed the House by a 65-34 margin and Senate by a 46-4 margin. Signed by the Governor on April 4, 1986, HB 14 became Chapter 2, Special Laws of Montana, March, 1986.

#### **ADDRESSING THE ISSUE: ROC SUBCOMMITTEE ON LIQUOR RECOVERY**

##### **April 1986**

To meet the requirements of HB 14 (2nd SS), the Revenue Oversight Committee appointed a four-member subcommittee to work with the Department in developing a liquor recovery plan.

The first meeting to address the issue was held April 28, 1986. As requested by the full Revenue Oversight Committee, the Department presented operating models of four options.<sup>18</sup>

1. The Status Quo model.
2. The Recovery model.
3. The Agency model.
4. The Wholesale model.

---

<sup>18</sup> See, "Model For Liquor Enterprise Fund", as "Exhibit #3", Minutes, ROC Subcommittee on Liquor Division Recovery, April 28, 1986, Montana Legislative Council, Room 138, State Capitol, Helena, Montana, 59620.

### **The Status Quo Model**

The status quo model was founded on the premise that the state's liquor enterprise would continue to be operated as it was then (April 1986) being operated. As presented, the model was the basis to which the other models were compared, and included:

1. gross sales and costs from FY 85;
2. expected gross sales (FY 86 through FY 89) with a change from the FY 85 base according to the expected change in gallons sold;
3. expected operating expenses (86 through FY 89) with a change from the FY 85 base according to inflation factors for personnel, and other operating costs and commissions;
4. expected cost of goods sold (COGS), state taxes and discounts (FY 86 through FY 89) with a change from the FY 85 base according to the expected change in gross sales; and
5. expected net income from operations (FY 86 through FY 89) that would result from deducting expected operating expenses, COGS, state taxes and discounts from expected gross sales.

It should be emphasized that it was these five elements to which the other three models were compared.

### **The Recovery Model**

The recovery model varied from the status quo model in that it included reductions in overhead costs and in that it included price changes. More specifically:

1. the model closed 7 stores, reduced hours, reduced agency commissions, and restructured prices; and
2. maintained the profit margin (12%) through a mix of other reductions in overhead.

### **The Agency Model**

The agency model would convert all state operated stores to agencies and would reduce the commissions paid to existing agencies and the newly converted agencies. The range of commissions expected by the DOR were from 10% downward to 7 1/2%.

### **The Wholesale Model**

The wholesale model would have extricated the state from the retail liquor business altogether. In addition, the model eliminated wine sales from expected gross sales and COGS, (which had no effect on profit, but altered the model's numbers nevertheless). This model would also have increased the discount percentage to retailers to the level that would allow operations to break even in FY 89 without a price increase.

### **Subcommittee Response**

After having been presented the options and discussing them with DOR officials, the Subcommittee asked the Department to incorporate a number of revisions into each of the models. Those revisions were intended to reflect suggestions and criticisms of earlier DOR plans, and to also reflect what the Subcommittee saw as potential effects or problems with the execution of any of the models. The Subcommittee's request included:

1. Price restructuring (each model);
2. The effect of the legal age to consume alcohol being raised to 21 years of age (each model);
3. The effect of the state setting the maximum price for liquor (each model);
4. Possible reductions to the stores bureau expenses in the agency and wholesale models;
5. Possible effect of operating the wholesale model at a "break even" point by either raising prices to cover operational costs or reducing the discounts to retailers;

6. The effect of increasing the number of retail outlets (using the wholesale model);
7. The possible effect of establishing a new license for off-premises consumption only (wholesale model);
8. The fiscal consequences of terminating employees, including unemployment compensation expenses (using the wholesale model);
9. Estimating the costs of administration (using the wholesale model);
10. The potential effect of having liquor agents purchase from a central warehouse and incurring the expense of freight (using the wholesale model);
11. Developing an estimate of the one-time savings to convert to a wholesale model; and
12. Estimating the effect of changes in necessary administration (for each model).

Additionally, the Subcommittee requested that the Department look at policy considerations relative to state control of alcohol, public convenience, and profit maximization.

## **MAY 1986**

### **May 8 Liquor Subcommittee**

At the May 8, 1986 meeting of the ROC Liquor Subcommittee, the Department presented the information requested at the earlier, April 28 meeting. In addition, the DOR presented three other options called "Agency 2", "Franchise 1", and "Franchise 2".

The Agency 2 model was similar to the Agency 1 model, except for the commission rate payable to the agent.

The franchise models were very similar to the agency model presented in April with the important difference being that the franchisee, rather than the state, would own

the liquor inventory. Profit to the franchisee would result from the state discounting its own return, based on the sales price minus the cost of goods sold.<sup>19</sup>

Table 1 illustrates the estimated profits for FY 86 through FY 89 for each of the options/models developed by the DOR.

Subcommittee discussion on the options was not focused on any single model. Each member speaking to the issue had questions about one model or another and how a particular change might affect the system or the liquor enterprise in a particular geographic area.

There seemed to be little consensus by the Subcommittee's members as to what the mission of the DOR Liquor Division actually was: (1) control, (2) convenience, or (3) profit.

---

<sup>19</sup> See, "Revised Models For Liquor Enterprise Fund", as "Exhibit #1" in Minutes, ROC Subcommittee on Liquor Recovery, Montana Legislative Council, Room 138, State Capitol, Helena, Montana 59620, May 8, 1986.

TABLE 1

**Estimated Profit From Seven Liquor Enterprise Models  
(in \$ millions)**

| <u>Model</u> | <u>FY86</u> | <u>FY87</u> | <u>FY88</u> | <u>FY89</u> |
|--------------|-------------|-------------|-------------|-------------|
| Status Quo   | 5.033       | 4.654       | 3.961       | 3.260       |
| Agency 1     | 5.561       | 5.372       | 4.970       | 4.565       |
| Agency 2     | 6.447       | 6.244       | 5.802       | 5.356       |
| Franchise 1  | 5.710       | 5.526       | 5.130       | 4.730       |
| Franchise 2  | 6.596       | 6.398       | 5.962       | 5.522       |
| Wholesale    | 0.480       | 0.373       | 0.189       | 0.002       |
| Recovery     | 5.886       | 5.681       | 5.389       | 5.089       |

=====

Source: "Exhibit #3", ROC Liquor Subcommittee Minutes, May 8, 1986. Note: Agency 1 and Agency 2 models differ in the commission rate. Franchise 1 and Franchise 2 differ in the incidence of transportation costs.

After considerable Subcommittee discussion of each of the options developed by the DOR -- with the discussion ranging from maximizing convenience to maintaining control to maximizing profit -- a review of the May 8 meeting Minutes reflects the absence of focus. The following excerpt indicates that the primary concern was revenue; however, a fuller reading of the Minutes of the May 8 meeting shows that to be misleading.

Two problems need to be addressed: the immediate shortfall, and the long range descending profit curve. There may be some middle-ground to address the problem by increasing prices and reducing operating expenses. . . Group consensus was to try and find some compromise that would set a new revenue projection acceptable for this interim until long-range changes can be made. Meeting a dollar objective would be through some combination of efforts to increase prices, close stores, and reduce inventory, which would result in an acceptable profit goal in the short term.<sup>20</sup>

---

<sup>20</sup> See Ibid., Minutes, May 8, 1986, pp. 14-15.

## **May 9 Revenue Oversight Committee**

As chairman of the Liquor Subcommittee, Senator Joe Mazurek outlined the Subcommittee's activities and recommendations of May 8 to the full Revenue Oversight Committee. Much discussion was had about the options developed by the Department. However, the Committee could not reach a consensus as to the principal mission of the Liquor Division, i.e. control, convenience, or profit.

The consensus that was reached was that the Committee recommend to the Legislature at the June special session that no stores be closed outright, but the Department should continue to look at ways of improving the profit picture through cost-cutting and price restructuring.

## **JUNE, AND THE THIRD SPECIAL SESSION**

### **June 12 Liquor Subcommittee Meeting**

The Subcommittee's June 12 meeting began as the May meeting had ended: there was considerable discussion about the fiscal issues of the liquor enterprise, but convenience and control continued to enter the dialogue.

At one point, ROC Chairman Williams suggested that "control" be the primary factor in deciding which model to recommend, further that "convenience" be the second consideration, and "profit maximization" the third factor.<sup>21</sup> His suggestion was largely ignored as the Subcommittee moved on to discussion of specific models.

More than any of the other options, the Department's "franchise" alternatives captured the imagination and interest of the Subcommittee. Under the franchise models, individuals would be licensed to sell liquor at retail for off-premises consumption. The state would profit from a mark-up above the cost of goods sold, and the licensees would profit from discounts (similar to commissions) allowed by the state acting as the wholesaler.

---

<sup>21</sup> Minutes, ROC Subcommittee on Liquor Recovery, Montana Legislative Council, Room 138, State Capitol, Helena, MT, 59620, June 12, 1986, p. 5.

As an interested person, Representative Bruce Simon cautioned the Subcommittee to "not become involved in a scenario with too many restrictions". He continued that his principal concern was that such restrictions as state imposed prices would require retailers to assume risks in excess of their management options.<sup>22</sup>

Throughout the meeting, the Subcommittee gradually focused on the franchise option. It would allow the state continued control, provide maximum convenience through the private enterprise system, and generate revenues for the Liquor Division consistent with the HB 500 (1985) "profit target" language.

As the meeting came to a close, Senator Bruce Crippen proposed a four-part motion:

1. That the DOR develop and present specific information relative to implementing a "franchise" model in the Billings and Kalispell market areas.
2. That if the franchise plan was eventually recommended by the Subcommittee, the Subcommittee recommend to the full ROC that the model be implemented in the Billings and Kalispell market areas on a trial basis.
3. That the full ROC recommend that the two stores proposed for closure and the proposal to reduce agency commissions from 10% to 8% be opposed by the Revenue Oversight Committee.
4. That a statewide restructuring of liquor prices be effected as proposed by the Department.

With the Subcommittee's attention directed towards finding an acceptable solution, the members voted unanimously in favor of Senator Crippen's motion.<sup>23</sup>

#### **June 16 Revenue Oversight Committee Meeting**

With Senator Mazurek as the point man, the Liquor Recovery Subcommittee presented its recommendation to the full Revenue Oversight Committee.

---

<sup>22</sup> Representative Simon had been, several years earlier, a member of the Governor's Council on Management. As a member of that panel, he was vocal (albeit unsuccessful) in trying to eliminate the state's role in the retail sale of liquor.

<sup>23</sup> Ibid., Minutes, June 12, 1986, p. 7.

Discussion focused on analysis done by the Liquor Division as to the implications of the "franchise" model in the Billings and Kalispell market areas. As presented by the DOR, the franchise model was workable from an administrative standpoint, but there were some concerns, principally the costs to private franchisees of purchasing liquor inventory and financing the debt, especially given the state's interest in paying as low a commission (in the form of a discount rate) as possible.

Resoundingly, the full Committee rejected the "trial franchise" recommendation (while reaching a positive consensus on the commission and price restructuring recommendations) and requested the Subcommittee and the DOR to develop an alternative proposal.

#### **June 19 Liquor Subcommittee Meeting**

Three days following the start of the third special session, the Liquor Subcommittee met for a fourth time, for the purpose of developing an alternative recommendation to be made to the full Revenue Oversight Committee.

In meeting the ROC's request for additional study, the Subcommittee agreed with the DOR's analysis that the level of investment needed to purchase inventory and service debt was likely to be in excess of the amount of commission that the DOR could offer and still return the proposed profit to the state. Consequently, the Subcommittee turned its attention to deferring recommendation on a franchise-type operation until the 50th Legislature could consider it fully.

Having dispensed (for the time being) with the franchise option, the Subcommittee turned its attention towards a revised agency option. The Department proposed that the Liquor Division's state-operated stores be converted to agency stores in areas where the conversion would financially benefit the state. Through this option, the three objectives of control, convenience, and profit could still be met.

Consequently, in an effort to take some form of positive action, the members unanimously agreed to the following motion by Representative Williams:

That the Liquor Recovery Subcommittee recommend to the Revenue Oversight Committee that:

1. the 34 single-market area stores be converted to "agency" stores;
2. the newly converted agency stores be compensated through a commission rate to be based on a sliding-scale structure to be developed by the Department;
3. no stores be closed;
4. no change be made in the 10% commission rates (then) currently being paid to existing agencies; and
5. the Department's recommendation for a general restructuring of liquor prices be implemented.

With the Subcommittee recommendation in hand, the members prepared to address the full Committee.

#### **June 25 Revenue Oversight Committee Meeting**

As background in presenting its recommendation to the Revenue Oversight Committee, the Liquor Subcommittee's chairman recapped the Subcommittee's charge under HB 14 (2nd Special Session). As adopted, House Bill No. 14:

1. restricted the Department's prerogatives in closing state liquor stores until July 1, 1986;
2. precluded the reduction in the commission rate paid to agency stores until July 1, 1986; and
3. required the Department of Revenue to work with the Revenue Oversight Committee to develop a liquor recovery plan.

The options that were discussed and debated by the Subcommittee -- a wholesale operation, the DOR's original recovery plan, a revised recovery plan, the franchise plan once recommended by the Subcommittee to the full Committee (and rejected), and variations on each of the alternatives -- were outlined once again by the chairman. The Subcommittee's meeting schedule was reviewed. The dozens of spreadsheets analyzing the numerous options were referred to and read into the record.

Perhaps the most succinct characterization of the situation is contained in a memorandum to the 49th Legislature from Revenue Oversight Committee Chairman J. Melvin Williams:

An indisputable fact facing the subcommittee was that any proposed solution would not be<sup>5</sup> perfect or satisfactory to everyone. We had a tough choice to make!<sup>4</sup>

With Committee consensus on Representative Williams' observation, the Subcommittee presented its recommendation from the June 19 meeting.

As might be expected, the full Committee saw fit to revise the recommendation. While following the general direction of converting state stores to agency stores, the Committee recommended that the process be done so as to cause the least amount of inconvenience and controversy. This was to be done by converting 17 of the stores to agencies in fiscal year 1987, and the remaining 17 single-market stores as the leases on those stores expired. In effect, the process would take about five years to complete.

In meeting its obligation under HB 14, the Revenue Oversight Committee adopted a formal recommendation referred to the 49th Legislature. The 7-point recommendation was presented to the Legislature on June 25, 1986, as follows:

The Revenue Oversight Committee recommends to the 49th Legislature and the Department of Revenue:

1. that the Department not close any state liquor store in Kalispell or Billings during fiscal year 1987;
2. that the Department not lower the commission rate paid to any agency store existing on June 1, 1986;
3. that the Department restructure the pricing of liquor products sold at retail in state liquor stores and state liquor agency stores;

---

<sup>24</sup> Memorandum from Representative J. Melvin Williams, Chairman, Revenue Oversight Committee, to Members of the 49th Legislature, June 25, 1986, Montana Legislative Council, Room 138, State Capitol, Helena, Montana, 59620.

4. that in the 17 communities with one state liquor store wherein the leases on the state liquor stores expire during fiscal year 1987, the Department convert the state stores to agency stores;
5. that the Department work towards conversion of state liquor stores in other communities with one state liquor store, with such conversion to be done in an orderly fashion, but without the Department exercising the early termination clause in any lease, unless early termination is done through negotiation;
6. that the Department work towards conversion of state liquor stores in communities with more than one state liquor store either through regulation, e.g. specifying that hours of operation and other restrictions and limitations must be the same as at state liquor stores, or through leasing provisions that would allow concurrent conversion of all state stores in a community to agency stores; and
7. that the commission rate paid to any agency store converted from a state store after July 1, 1986, conform to a sliding scale based on the value of sales of historical record in the converted state liquor store.

Therefore, in meeting the requirement of Section 4, House Bill No. 14 of the March 1986 Special Session, it is the sincere and reasoned recommendation of the Revenue Oversight Committee that the members of the 49th Legislature accept this proposal, and that the Department of Revenue implement the recommendations in an orderly and timely manner.<sup>25</sup>

### **Legislative Action and Conclusion**

The response to the Revenue Oversight Committee's recommendation was generally favorable. House Bill No. 30 (June 1986), an act to generally revise appropriations for fiscal year 1987, incorporated the ROC's recommendation into the narrative portion of the Department of Revenue's appropriation:

The division is directed to implement the recommendations of the Revenue Oversight Committee dated June 19, 1986, with respect to Liquor Division Recovery, provided the Department shall hold timely public hearings prior

---

<sup>25</sup> Ibid., Memorandum, J. Melvin Williams, June 25, 1986, p. 3. As printed in the Memorandum, the date of the recommendation was misrepresented as May 19. Several copies of the May 19 dated recommendations were circulated; however, upon discovery of the error, corrected versions dated June 19, 1986 were distributed as the official recommendation of the Revenue Oversight Committee.

to closing any state store or agency and prior to implementing a price restructuring.<sup>26</sup>

As part of the generally revised appropriations bill, the Committee's recommendation was adopted 43-3 by the Senate and 77-21 by the House of Representatives.<sup>27</sup>

A measure that would have prohibited the closure of any state liquor store or any state agency store, House Bill No. 50 (June 1986), garnered considerable support in the House, but failed on a vote of 51-48.<sup>28</sup> HB 50 was introduced in the House under a suspension of the rules. Its introduction followed the recommendation of the Revenue Oversight Committee being distributed to members of the legislature. Sponsored by Representative Bob Pavlovich, HB 50 embodied the feeling of a number of legislators that the Department should not be allowed to close any state or agency liquor store that was making a profit, even if the profit was contributing to the decline in total profits by being less than the 13% profit target established in the appropriation bill's narrative.

Consequently, the work accomplished by the Revenue Oversight Committee, the ROC Subcommittee on Liquor Division Recovery, and the Department of Revenue effected changes in the state's liquor enterprise. As a final note, however, all the parties involved agreed that the special session solution was only a temporary fix, and that the decline in liquor profits due to declining sales would return in the future.

db\c:05127a.wp

---

<sup>26</sup> House Bill No. 30, Special Laws of 1986, June, p. 105.

<sup>27</sup> History and Final Status of the Forty-Ninth Legislature, Montana Legislative Council, Room 138, State Capitol, Helena, Montana, 59620, p. 11.

<sup>28</sup> Ibid., Combined Final Status, p. 20.

**PART THREE**  
**CHAPTER FIVE**

**Bill No. 701: In-kind Payment of Inheritance Taxes**

**INTRODUCTION**

Montana is rich in cultural history given its relatively short life as a state of the union. Artists such as C.M. Russell, writers such as A.B. Guthrie, and musicians such as Charlie Pride have given Montana much in terms of historic and cultural assets.

Others, too, have played an important role in Montana's cultural history: William Clark, Marcus Daly, W.G. Conrad and his brother Charles Conrad all became Montana success stories and left their legacy in one form or another.

Fortunately for future Montanans, the earliest state Legislature established the Montana Historical Society. Subsequent Legislatures provided additional means of preserving Montana's cultural heritage. From dedicating a portion of the coal severance tax receipts for cultural and aesthetic projects<sup>1</sup> to the outright purchase of original C.M. Russell artworks,<sup>2</sup> Montana's Legislatures have recognized the value of preserving Montana's cultural heritage.

The 49th Legislature saw fit to continue the state's commitment to historical preservation with the adoption of House Bill No. 701, (Ch. 736, L. 1985). As adopted, the bill allowed the state's Department of Revenue to accept the Daly Mansion near Hamilton, Montana, as an "in-kind" payment of estate and inheritance taxes. The bill also provided that other types of property of unique historical value could be accepted by the DOR as in-kind payment of estate taxes.

This chapter recounts the activities of the Revenue Oversight Committee during the 1985-86 interim in dealing with the provisions of House Bill No. 701.

---

<sup>1</sup> Section 15-35-108(3)(i), Montana Code Annotated.

<sup>2</sup> House Bill No. 961, L. 1985.

## THE BILL

Aside from the fact that Montana's Constitution prohibits the passage of local or special legislation,<sup>3</sup> it was apparent from its introduction that HB 701 was directed at preserving the Daly Mansion near Hamilton, Montana. Both the title and section 7 of the bill specifically mentioned and approved acceptance of the Daly Mansion. However, and perhaps in recognition of the constitutional limitation, the bill was written in terms general enough to allow property other than the Daly Mansion to be remitted as in-kind payment as well. As stated in section 1 of the bill, the intent was

. . . to allow the payment of inheritance and estate taxes by the transfer to the state of unique objects of significant historical or artistic interest, extremely unique sites or buildings of historical interest, and easements and other recognized interests in land to conserve unique open space and to preserve wildlife habitat, park, recreational, historic, aesthetic, cultural, and natural values on or related to land, while limiting the impact of such transfers on the revenue collected under [Title 72, chapter 16, MCA].<sup>4</sup>

Once identified as meeting the criteria of having "unique historical or cultural significance", the property and in-kind payment were subject to other criteria. First, the total estate and inheritance tax due could not exceed \$100,000; second, the value of the in-kind payment could not exceed \$400,000; and third, the payment had to be approved by the legislature.<sup>5</sup>

In order to receive approval, and in fact to even be considered for approval by the legislature under the provisions of the bill, a lengthy review process had to be completed. The process involved an application to the Department of Revenue, notification of the legislative Revenue Oversight Committee, appointment by the Revenue Oversight Committee of an In-kind Review Committee, an analysis by and report from the In-kind Review Committee to the Revenue Oversight Committee, and a recommendation from the Revenue Oversight Committee to the legislature.

---

<sup>3</sup> Article V, Section 12, Montana Constitution.

<sup>4</sup> Section 1, HB 701, (Ch. 736, L. 1985).

<sup>5</sup> Section 4, HB 701, (Ch. 736, L. 1985).

From presentations made by the bill's sponsors and testimony presented during hearings on the bill, it was apparent that the review process was, once again, directed towards the Daly Mansion.<sup>6</sup> Ironically, even though the rigorous review process was developed with the Daly Mansion at issue, the bill as adopted provided legislative approval for accepting the property. However, actual acceptance of the Daly Mansion as in-kind payment was problematical early on.

## THE DALY MANSION

The Daly Mansion referred to in HB 701 was (and is) actually comprised of much more than a "mansion" per se. The property included furnishings, "out buildings" such as stables, and a considerable amount of land, much of which was prime wildlife habitat.

From the beginning of the debate over HB 701, the condition of the Daly property was always at issue. Outright proponents of the acquisition alleged that the property was in such a condition as to be fairly easily restored, with only a moderate investment in time and money. More cautious proponents to the acquisition painted quite a different picture.<sup>7</sup>

---

<sup>6</sup> See Minutes of the House Committee on Taxation, February 15, 1985, and the Senate Committee on Taxation, April 9, 1985, 49th Legislative Session, Montana Historical Society, Helena, MT.

<sup>7</sup> In discussing the condition of the property, the following exchanges, recorded in the House Taxation Committee's Minutes, are informative.

Representative Zabrocki said Representative Fritz told him there would be no cost involved in renovating the Mansion and asked if this information were correct. Representative Asay replied the costs of renovating the Conrad Mansion in Kalispell, were approximately \$100,000, and that the Mansion is now in a position to be self-supporting. . . .

Representative Zabrocki asked what condition the Mansion is in. Chairman Devlin stated the foundation and walls are good, but the roof is questionable. Dr. Archibald replied that an architect looked at the Mansion and found no structural problems. He said the Mansion has been closed up for 40 years and is in remarkable condition after being closed for that length of time. (Minutes, House Taxation, March 21, 1985.)

The controversy associated with the bill, and perhaps more appropriately, the Daly Mansion, was not limited to the public hearings before the respective Committees on Taxation. After having once rejected the bill, the House Taxation Committee was directed by the full House to give the bill further consideration. Similarly, after having once recommended "do not concur", the Senate Taxation Committee reversed itself, amended the bill further, and eventually adopted an amended version of the bill.

As finally adopted by the Senate, (and subsequently concurred in by the House), the bill authorized the Department of Revenue to accept the Daly Mansion as in-kind payment of inheritance and estate taxes. After considerable dickering during 1985 and 1986 among representatives of the estate, the Montana Historical Society, and the Department of Revenue, the state eventually took in-kind payment of the Daly Mansion in December of 1986.

Acceptance of the Daly property was not the end of House Bill No. 701, however. In continuing to recognize the "general application" language of the Constitution, the bill also allowed other properties, under certain circumstances, to be accepted as in-kind payment.

#### **THE MOSS MANSION**

"The Moss Mansion" is the title given to the residence of the late P.B. and Mattie Moss in Billings, Montana. Mr. Moss was a resident of the Billings community for over half a century and was a driving force in the economic development of the city. The house itself was designed at the turn of the century by architect Henry J. Hardenberg, perhaps best known for his designs of the Waldorf-Astoria Hotel and the Plaza Hotel in New York City.

The Moss family's prominent status in the historical development of Billings and Mr. Hardenberg's place in American architecture were adequate criteria to nominate the Moss Mansion as a property of "unique historical significance". Perhaps fortunately, the property also met all of the other criteria stated in House Bill No. 701 for the property to be considered for in-kind payment of inheritance and estate taxes. Consequently, in early 1986 the Montana Historical Society (MHS) approached the

Department of Revenue (DOR) with an application for in-kind payment of inheritance and estate taxes on the Moss estate.

Upon receipt of the application, the DOR informed the Revenue Oversight Committee (ROC) that an in-kind payment had been requested as provided under HB 701. As required by the bill, the ROC appointed an In-kind Review Committee to analyze the Moss Mansion proposal, report its findings to the ROC, and recommend either acceptance or denial of the in-kind payment. Appointment of the In-kind Review Committee was completed by the ROC on March 21, 1986.

During the spring and summer of 1986, the In-kind Review Committee met and considered recommending acceptance of the Moss Mansion. Acquisition costs, maintenance costs, and other budgetary matters were at the core of deliberations.<sup>8</sup>

Within the time limitations imposed in the bill, 180 days, the Committee reported to the Revenue Oversight Committee on September 11, 1986. Although never stated succinctly in its report to the ROC, the In-kind Review Committee recommended that the Moss Mansion be accepted by the DOR as in-kind payment of a portion of the inheritance and estate taxes due from the Moss estate.<sup>9</sup>

The Committee's report was accepted by the ROC on September 11, 1986, on a motion by Senator Hager.<sup>10</sup> On the following day, Senator Hager moved to recommend that the DOR accept the in-kind payment of inheritance taxes on the Moss estate.<sup>11</sup>

Although there was some controversy over the fiscal effect of accepting the property as in-kind payment -- as a matter of record, the state was facing a budget

---

<sup>8</sup> See Exhibits 1, 3, 4, and 5, Minutes, Revenue Oversight Committee, September 11 and 12, 1986, Montana Legislative Council, Helena, MT.

<sup>9</sup> The "Moss estate" referred to here is actually the estate of Melville Moss, a lineal descendent of P.B. and Mattie Moss.

<sup>10</sup> Minutes, Revenue Oversight Committee, September 11 and 12, 1986, Montana Legislative Council, p. 6.

<sup>11</sup> Both of Senator Hager's motions were unanimously approved and, as a result, Senate Bill No. 26 was drafted and introduced during the 50th Legislative Session.

unbalanced in an amount approximating \$100 million -- the bill was adopted and signed by the governor.<sup>12</sup>

## SUMMARY

For as long as Montana has enjoyed statehood, efforts have been made to preserve its artistic and cultural heritage. The Montana Historical Society was created as one of the first official acts of the state legislature. Works of art have been purchased by subsequent legislatures. The C.M. Russell museum was constructed as an integral part of the Montana Historical Society's building. These efforts, and others, evidence Montanans' commitment to the state's history.

In keeping with the tradition of historic and cultural preservation, the 49th Montana Legislature adopted House Bill No. 701, (Ch. 736, L. 1985). The bill approved acquisition of the historic Daly Mansion near Hamilton, Montana, and allowed for the acquisition of the Moss Mansion in Billings, Montana. The acquisitions were to be effected through the "in-kind" payment of inheritance and estate taxes.

Consequently, with foresight similar to that of Montana's earliest local statesmen, legislators in 1985 and 1987 chose to preserve unique elements of the state's history. Given the financial straits within which the 49th and 50th Legislatures had to navigate, the effort is perhaps even more noteworthy. Finally, as the provisions of House Bill No. 701 are still on the books, the avenue by which Montana's unique properties may be preserved through in-kind payment of inheritance and estate taxes remains open.

7202b.wp

---

<sup>12</sup> See Ch. 54, L. 1987. Note: According to Department of Revenue personnel, the mansion is expected to be accepted in mid-1987 as in-kind payment of inheritance and estate taxes.

## PART FOUR

### Miscellaneous Issues Before the Revenue Oversight Committee

#### CHAPTER SIX

##### Montana's Tax Incentive for the Production of Alcohol: Problems Experienced by Montana Producers

#### LEGISLATIVE HISTORY OF ALCOHOL PRODUCTION INCENTIVES

The first state incentive for the production of fuel grade alcohol to be blended with gasoline for the production of gasohol was established in 1979 by the 46th Legislature. The incentive took the form of a lower gasoline license tax applied to gasohol than to gasoline.

Prior to 1979, gasohol was taxed at the same rate as gasoline. In 1979, the Legislature passed Senate Bill No. 42, (Ch. 576, L. 1981), establishing the tax rate applicable to gasohol at:

- (a) 2 cents per gallon for the period April 1, 1979 through March 31, 1985;
- (b) 4 cents per gallon for the period April 1, 1985 through March 31, 1987; and
- (c) 6 cents per gallon for the period April 1, 1987 through March 31, 1989.

This was an incentive because the gasoline license tax for nonaviation gasoline was 8 cents per gallon in 1979. (15-70-204, MCA.)

In 1981, the 47th Legislature enacted a temporary 1-cent per gallon add-on to the gasoline license tax. (Ch. 632, L. 1981.) Relative to the temporary 9 cents per gallon gasoline tax, the 2 cents per gallon tax on gasohol was an increased incentive for gasohol consumption (and therefore, alcohol production).

1983 brought several changes to Montana's fuel taxes. House Bill No. 16 (Chapter 624, L. 1983), made permanent the temporary 1-cent add-on adopted in 1981. It also increased the gasoline license tax by an additional 6 cents per gallon, resulting in a gasoline license tax rate of 15 cents per gallon.

House Bill No. 780 (Ch. 649, L. 1983), enacted the Alcohol Tax Incentive and Administration Act of 1983. This legislation repealed the lower, but gradually increasing, tax on gasohol adopted in 1979, and replaced it with a direct incentive for the production of alcohol that was to be blended with gasoline. The incentive was to begin at 70 cents per gallon of alcohol produced for gasohol, falling gradually to 50 cents per gallon on April 1, 1985, to 30 cents per gallon on April 1, 1986, and to no incentive on and after April 1, 1989.

Apparently the incentive was reestablished at 70 cents per gallon of alcohol because 70 cents was the (then) current incentive. Some arithmetic had to be done to arrive at the 70-cent figure because the previous incentive had been a lower tax rate on gasohol than was applicable to asoline. The difference was 2 cents tax per gallon of gasohol compared to 9 cents tax per gallon of gasoline.

In blending gasohol, the ratio of gasoline to alcohol is typically 9 or 10 to 1. Consequently, every one gallon of alcohol is blended with 9 or 10 gallons of gasoline.

Because the tax differential between gasohol and gasoline was 7 cents per gallon, (9-cent gas tax minus the 2-cent gasohol tax), and the blending ratio was about 10 to 1, the legislature established the incentive at 70 cents per gallon of alcohol. The gradually decreasing incentive for succeeding years was similarly calculated and adopted.

In the same 1983 legislation, HB 780, gasohol was subjected to taxation at the same rate as nonaviation gasoline; at that time, 15 cents per gallon. This effectively reduced the incentive payable to alcohol producers by 15 cents per gallon of alcohol.

The 49th Legislature made several changes in 1985 to the state's alcohol tax incentive program. These changes included:

- (a) clarifying that alcohol produced in Montana from Montana agricultural products, including wood products, exported and blended out of state is eligible for alcohol production incentive payments;

- (b) extending until April 1, 1987, the 30-cent per gallon incentive for the production and blending of alcohol, (previously, the date had been April 1, 1986);
- (c) removing the language that reduced the tax incentive payment by the 15-cent per gallon gasoline license tax;
- (d) establishing a nominal maximum payment per alcohol producer at \$1,000,000 in any 12-month period; and
- (e) establishing an absolute maximum payment allowance by the Department of Revenue at \$2,500,000 in any 12-month period for all producers combined.

The tax incentive for the production of alcohol for use in gasohol remained at 50 cents per gallon of alcohol until April 1, 1987. Beginning April 1, 1987, the tax incentive decreased to 30 cents per gallon. Any tax incentive payments made to producers will not be reduced by the rate of the state's gasoline license tax. Finally, after April 1, 1989, no tax incentive will be paid by the State of Montana for the production of alcohol.

#### ADMINISTRATION OF INCENTIVE PAYMENTS

The "administration" of tax incentive payments is addressed primarily in administrative rules, but partially in statute as well. Section 15-70-523, MCA, reads:

15-70-523. Application for payment of tax incentive.

(1) The claimant shall apply for payment of tax incentive by signed statement, on a form furnished by the department. The form must be accompanied by:

(a) the original production records and invoices issued to the gasohol dealer at the time of sale and delivery, showing total gallons of alcohol sold; and

(b) a certificate of blending issued by the alcohol purchaser showing the total gallons of alcohol blended and the date of blending.

(2) Application for the payment of the tax incentives must be filed with the department not later than the 25th day of the calendar month following the month for which the claim is being made.

Section 15-70-511, MCA, requires licensure for alcohol producers to be alcohol distributors, and 15-70-512, MCA, requires the filing of a monthly distributor's statement.

15-70-512. Distributor's statement. Each alcohol distributor shall, not later than the 25th of each calendar month, render to the department a statement, signed by him, that includes the following:

- (1) the number of gallons of alcohol manufactured or imported by the distributor during the preceding calendar month;
- (2) the name of each gasohol dealer to whom he sold alcohol and the number of gallons sold to each dealer; and
- (3) such other information as the department may reasonably require.

Sections 15-70-513 and 15-70-514, MCA, establish certain requirements for recordkeeping and the rights of the department to examine such records.

Section 15-70-527, MCA, imposes a penalty for failure by a distributor to obtain a license or file the required reports.

Under 15-70-104, MCA, the department has general rulemaking authority to "adopt, publish, and enforce rules consistent with and necessary for carrying out the provisions of this chapter", which includes the incentive for alcohol blending.

The formal administrative requirements for alcohol incentive payments are contained generally in Title 42, chapter 27, sub-chapter 6, of the Administrative Rules of Montana (ARM). The "guts" of the administrative requirements are contained in 42.27.603, ARM.

As provided by statute, the rules require application for incentive payments to be made not later than the 25th day of the month following the month(s) during which the alcohol was sold. Section 42.27.603(1), ARM, also limits payments such that an "alcohol distributor may not submit more than one application during a month."

Subsections (2) through (4) of 42.27.603, ARM, outline an extensive list of documents and information that must accompany an application. Subsection (6) states that the department will begin processing the applications on the 25th day of each month.

Subsection (7) establishes the department's authority to withhold payment for missing or incorrect information. The subsection reads:

(7) If the information on the alcohol tax incentive payment application by the alcohol distributor does not match the information on the gasoline distributor's report or other information supplied to the division, the division will withhold payment of the alcohol tax incentive until such time as the division can determine the accuracy of the alcohol tax incentive application.

## **SUMMARY OF HISTORY AND LEGAL REQUIREMENTS**

Incentives for the production of fuel grade alcohol have been available in Montana since 1979. Since the establishment of the incentive in 1979, the amount of the incentive has changed on several occasions and is scheduled to change once again in 1989.

The Montana Code Annotated lays the foundation for the administration of alcohol incentive payments. The Administrative Rules of Montana build on that foundation.

A careful reading of the administrative rules and applicable code sections leads to the conclusion that Montana's Department of Revenue has adopted administrative procedures that carry out the statutory requirements of the Alcohol Tax Incentive and Administration Act of 1983, as amended.

## **THE ISSUE BEFORE THE COMMITTEE**

On September 7, 1985, Mr. Bruce Kania, President of A. E. Montana, addressed the Revenue Oversight Committee with concerns he had regarding the tax incentives for the production of gasohol. A. E. Montana is an enterprise producing fuel grade alcohol (anhydrous ethanol) and is located in Manhattan, Montana.

The general areas of concern presented by Mr. Kania included problems he had encountered relating to the production of gasohol, production incentives provided by the 1979, 1981, and 1983 Legislatures and payable by the Department of Revenue, and loans made to A. E. Montana by the Department of Natural Resources and Conservation for the production of gasohol.

It was Mr. Kania's contention that the 1979 and 1981 Legislatures had made certain commitments to the (then) fledgling alcohol industry that led entrepreneurs to

invest in alcohol production. Mr. Kania further contended that the 1983 and 1985 Legislatures reneged, to a considerable extent, on the commitments made by previous Legislatures.

Finally, Mr. Kania outlined a series of problems that he associated with the Department of Revenue (DOR) and the Department of Natural Resources and Conservation (DNRC). He outlined problems he had encountered with the DOR concerning payment of the alcohol production incentives provided in 15-70-522, MCA, especially payment of the incentive for exported alcohol.

His problems with the DNRC apparently stemmed from loans made by the Department to A. E. Montana. The loans established a first lien on the firm's property and, as a first lien, were causing the company problems in gaining additional financing.

John LaFaver, Director of the Department of Revenue, and Louise Moore, chief of the DNRC's Conservation and Energy Bureau, responded to many of Mr. Kania's contentions, and to questions from the Committee at its meeting in November of 1985.

Following Mr. Kania's presentation and the state officials' responses, the Committee requested its staff to contact Montana's other alcohol producers to determine if they had experienced similar problems with the DOR or the DNRC.

## COMMENTS FROM MONTANA'S ALCOHOL PRODUCERS

Montana currently has four alcohol producers registered with the Department of Revenue. Those four are: A. E. Montana, Manhattan; Sage N Cedar, Inc., Terry; Alcotech, Inc., Ringling; and Southwest Alcohol Producers, Inc., Dillon.

The amount of alcohol produced in 1985 by each of the producers is listed below:

| <u>Producer</u>            | <u>January to November<br/>1985 Production<br/>(gallons)</u> |
|----------------------------|--------------------------------------------------------------|
| A. E. Montana              | 697,819                                                      |
| Alcotech, Inc.             | 917,847                                                      |
| Sage N Cedar, Inc.         | 11,235                                                       |
| SW Alcohol Producers, Inc. | 30,020                                                       |

## ESTABLISHING THE SCOPE OF THE PROBLEMS

In an effort to determine what the working relationship was between Montana's alcohol producers and the Departments of Revenue and Natural Resources and Conservation, a letter was sent to the producers asking about those relationships.<sup>1</sup>

Responses to the letter varied. Mr. Ron Johnson of Southwest Alcohol Producers first responded by telephone, and later by letter. Representatives of Alcotech and Sage N Cedar did not respond at first and were, consequently, contacted by telephone.

### Sage N Cedar, Terry, Montana

According to the DOR, Mr. Kelly Hoagland is the representative of Sage N Cedar in Terry. A December 6, 1985, telephone call to Sage N Cedar resulted in a number

---

<sup>1</sup> A letter was not sent to Mr. Kania as his concerns had been well represented to the Revenue Oversight Committee, and in some measure, the 49th Legislature as a whole. Mr. Kania was notified by telephone that the letter was sent to the other producers. A copy of the letter is on file at the Montana Legislative Council, Helena, Montana.

not in service. A subsequent call to Mr. Hoagland's home netted a conversation with Mrs. Hoagland; Mr. Hoagland was not available.

The substance of the conversation with Mrs. Hoagland was that Sage N Cedar had had no problems with the Department of Revenue or the Department of Natural Resources and Conservation. In Mrs. Hoagland's opinion, the alcohol business was "great", but other business concerns had demanded so much attention that alcohol production from Sage N Cedar was, at that time, at a standstill.

Mrs. Hoagland further offered to have her husband contact the Legislative Council if he had concerns or problems with the departments. Mr. Hoagland did not contact the Council.

#### Alcotech, Inc., Ringling, Montana

During the first week in December of 1985, two telephone calls to Alcotech, Inc., in Ringling went unanswered. A subsequent call to Mr. Gordon Doig's home was answered and led to Mr. Doig at another number. (Mr. Doig was a principal in Alcotech, Inc.)

In reference to the relationship between Alcotech, Inc., and the two state departments, Mr. Doig said that he had had no problems at all with DNRC, but that he had experienced one problem with DOR.

The problem with the DOR was caused by the department's reluctance to make tax incentive payments on alcohol that was produced in Montana, but exported to be blended as gasohol. Mr. Doig and the DOR settled the issue, but only after Alcotech, Inc., had filed suit.<sup>2</sup>

Mr. Doig also stated that in years past, the DOR had made tax incentive payments on a weekly or biweekly basis. The then current procedure resulted in monthly payments coming as late as two months after the actual sale of the alcohol. The

---

<sup>2</sup> This situation was corroborated in a letter from DOR Director John LaFaver to Representative Mel Williams dated September 4, 1985.

situation was evidenced by the fact that Alcotech received payment on December 12 for alcohol sold in October.

Mr. Doig speculated that the delay in payment was caused by verification of receipts sent to and received by the DOR from producers and blenders. He also said that it would be no problem for Alcotech to submit payment applications more frequently than once a month, or earlier than the 25th of the month.

#### Southwest Alcohol Producers, Inc., Dillon, Montana

Southwest Alcohol Producers' representative, Mr. Ron Johnson, contacted the Legislative Council twice during November of 1985. Mr. Johnson simply stated, "I really do not have a great deal of problems as far as the Revenue Department is concerned."

His only concern regarding the incentive payments was the state's formula for determining the payments. Specifically, he felt that offering an incentive in one code section and reducing the incentive by the amount of gasoline tax as required by another code section was "ridiculous". He speculated that that practice was causing Montana's alcohol producers to seek markets out of state, rather than focus on in-state sales.

#### **SUMMARY AND CONCLUSION**

In summary, Montana's practice of providing incentives for the production of alcohol has a history of about seven years. During that period, the incentive changed from 70 cents per gallon of alcohol, to 55 cents per gallon, to the 50 cents per gallon, and finally to the 30 cents per gallon available beginning April 1, 1987.

The provisions of the alcohol tax incentive payment program are contained in statute and in administrative rules. The rules are a reasonable attempt to effect the broad program policy outlined in statute.

With respect to the issue of exports, the 49th Legislature adopted statutory changes that clearly allow incentive payments for alcohol produced in Montana, but exported

and blended as gasohol elsewhere. The Legislature also eliminated the statutory language requiring a reduction in the per gallon incentive by the per gallon amount of gasoline license tax. And finally, the 1985 Legislature set the new incentive at 50 cents per gallon of alcohol, until April 1987.

Montana's alcohol producers have varying relationships with the Departments of Revenue and Natural Resources and Conservation. Two producers, Sage N Cedar and Southwest Alcohol Producers, apparently have no problems at all with either agency.

Alcotech, Inc., of Ringling, Montana, and A. E. Montana of Amsterdam, Montana, both experienced a disagreement with the Department of Revenue over the payment of the incentive for alcohol produced in Montana and exported. The Department and Alcotech reached a compromise settlement on this issue -- after Alcotech filed suit. Apparently, the Department and A. E. Montana could not reach agreement until management at A. E. Montana was changed. Following the change, the DOR and the producer did reach a mutual agreement.

From the responses given by representatives of Alcotech, Inc., Sage N Cedar, Inc., and Southwest Alcohol Producers, Inc., it appears that the relationships between Montana's alcohol producers and the Department of Revenue and Natural Resources has been generally good since the tax incentive has been available. However, the relationship between A. E. Montana and the Departments of Revenue and Natural Resources and Conservation was not as amicable as the other producers'.

#### **EPILOG -- COMMITTEE ACTION**

As a result of staff research concluding that no significant policy or procedural problems existed with respect to alcohol production tax incentives, the Revenue Oversight Committee chose to not recommend any action, legislative or

administrative.<sup>3</sup> It appears that the Committee chose to follow the maxim, "If it's not broken, don't fix it."

---

<sup>3</sup> No formal motion was made, nor was any formal consensus reached on the alcohol issue. However, Committee discussion of the staff's findings indicated that no problem was perceived by the Committee. Consequently, the ROC membership closed discussion of the issue at the Committee's January 10, 1986 meeting and did not discuss the matter again during the interim.



## CHAPTER SEVEN

### Vehicle Fees and the Revenue Oversight Committee

#### INTRODUCTION

House Bill No. 870 (HB 980) and Senate Bill No. 142 (SB 142) of the 49th Legislature each increased the fee in lieu of tax paid on automobiles and light trucks. The additional fee provided for in HB 870 was to be distributed to the local government block grant program. The fee provided for in SB 142 was to be used to fund criminal expenses of district courts. Each of these additional fees was to be added to the basic fee for the light vehicle, i.e., the fee based on the vehicle's weight and age.

As the two bills made their way through the legislative process they were amended repeatedly, both in standing committees and in conference committees. While the original intent of placing an additional fee on the vehicles for a specific purpose was preserved, an apparently inadvertent amendment struck a provision in then existing statutory language that escalated the basic fee in lieu of tax by the "implicit price deflator for personal consumption expenditures" (PCE), a measure of inflation. Consequently, an additional fee was added to the basic fee, while at the same time the basic fee was reduced.

The effects of the HB 870/SB 142 situation were several. First, eliminating the PCE inflator from the basic vehicle fee would have resulted in the fees dropping to 1982 levels rather than increasing to the projected 1986 and 1987 levels. In dollar terms, the difference in the basic fee would have been from \$2 to \$21 less per vehicle than it would have been with the PCE inflator applied. The total revenue that would have been lost amounted to about \$9.442 million as estimated by the Governor's Office of Budget and Program Planning. Second, the "additional fees" generated by the two bills amounted to an estimated \$9.707 million revenue increase.

Taken together, the decrease caused by the elimination of the PCE inflator and the increase caused by the additional fees imposed by the two bills amounted to a net increase in revenue from light vehicle fees of about \$265,000 over the 1984-85

biennium. However, due to the distribution of the fees some governmental entities would have suffered more than others. For example, the effect to counties would have been a net gain of about \$4.2 million while the effect to school districts would have been a net loss of about \$2.1 million. Statewide, all other entities receiving revenue from light vehicle license fees would also have suffered a net loss in revenue.

## OPTIONS PROPOSED

The most reasonable options available to the Legislature were outlined to the Revenue Oversight Committee on June 7, 1985:

1. A special session could be called before July 1, 1985, to correct the situation created by the elimination of the PCE inflator. A reenactment of the PCE inflator would restore, primarily to local governments and school districts, the additional funding originally intended by the legislation.
2. Postpone legislative action until other issues demand a special session. Should that occur, the light vehicle license fee situation could also be addressed. This option would likely result in a loss of anticipated revenue because the effective date of the legislation at issue was July 1, 1985. Assuming the PCE inflator were restored during a future special session, the intervening months would be regained but the administrative costs associated with a retroactivity provision could be prohibitive.
3. The Legislature could choose to defer action indefinitely. This option would return the problem to local governments and school districts. The lost and foregone revenues could either be absorbed by increased local taxes, by reducing expenditures, or both.

## COMMITTEE DISCUSSION

Following the staff's presentation of the problem and the several options, the Committee discussed the issue at length.<sup>4</sup> It was pointed out that the actual intent of the amendment (that struck the inflation adjustment) was to apply the PCE

---

<sup>4</sup> See Minutes, Revenue Oversight Committee, June 7, 1985, Montana Legislative Council, State Capitol, Helena, Montana, pp. 12-14. *passim*.

deflator only to the basic fee in lieu of tax, and not to the charges for district courts or the local government block grant program.<sup>5</sup>

In addition, the statewide fiscal implications were outlined by the governor's budget director and debated by the Committee members. As presented by David Hunter, Director of the Office of Budget and Program Planning, the revenue losses statewide by jurisdictional category were: \$730,000 for cities; \$2 million for counties; \$2 million for the university system; \$4 million for the state's school districts; and \$550,000 to be distributed to the other taxing jurisdictions.<sup>6</sup>

However, Mr. Hunter attempted to portray the deficit in a different light by pointing out that in the Missoula school district the loss would amount to only 3 percent of the district's total budget. It was his contention that "it's probably no higher than that for other school districts or for other cities or counties. Your decision is whether that is enough to cause you to have a special session".<sup>7</sup>

Indeed, that was the question. Representative Dan Harrington pointed out that the \$82,000 impact in Butte would have significant effects. Senator Tom Hager had a similar perception and made a motion that the Revenue Oversight Committee recommend that a 1-day special session be called for the purpose of addressing the revenue loss caused by the inadvertent legislative action.<sup>8</sup>

While there was general support for the motion, there was also considerable concern that such a call could be limited to one day and specifically to the subject of vehicle fees. Senator Crippen voiced the concerns thus:

---

<sup>5</sup> Ibid., p. 13.

<sup>6</sup> Ibid., p. 13.

<sup>7</sup> Ibid., p. 14.

<sup>8</sup> Ibid., p. 14.

. . . I agree that the problem has to be taken care of. But we're assuming that we would come back for one day and solve the problem. When 150 legislators gather, that may not be the case; there may be other things that someone will want considered in a special session.<sup>9</sup>

In an effort to address as many concerns as possible, Committee consensus was to have the staff prepare legislation that would effect the original purposes of HB 870 and SB 142.

Upon reviewing the completed draft legislation, Senator Hager's motion, including amendments, passed unanimously. As adopted, the motion stated that: (1) the exhibited draft legislation be proposed as the solution to the problem, and (2) the special session be called and completed prior to July 1, 1985.<sup>10</sup>

Whether or not the Revenue Oversight Committee's action was causal, the Legislature called itself into special session on June 28, 1985. Senate Bill No. 1, (Ch. 1, Special Laws of 1985, (June)), was passed and approved, in effect implementing the recommendation of the Revenue Oversight Committee.

## SUMMARY

Following adjournment of the 49th Montana Legislative Session, it was discovered that an amendment to a vehicle licensing bill inadvertently reduced revenue to local governments and schools by over \$9 million. Due to the complexity of the distribution formula associated with the vehicle fees, counties would have seen increased revenues while school districts would have generally suffered losses.

Upon discovery, the Legislature's Revenue Oversight Committee addressed the issue. As was similarly done with the state's liquor enterprise, alcohol tax incentive program, and other revenue matters, the Committee identified the issue as having

---

<sup>9</sup> Ibid., p. 14.

<sup>10</sup> A copy of the letter sent to each legislator and the governor regarding the Committee's recommendation is on file in the Legislative Council, letter dated June 10, 1985.

statewide implications, analyzed it, and arrived at a conclusion and a recommendation.

The Committee's recommendation -- rectifying the situation with full funding of the program -- was adopted by the Legislature meeting in special session. Causal influence aside, the Committee's assessment of the problem and its recommended solution are testimony that the Committee continued during the 1985-86 interim to perform its statutory responsibility, i.e., oversight of the state's tax and revenue system.



## CHAPTER EIGHT

### Summary of the Activities of the Revenue Oversight Committee 1985-86 Interim

#### Burlington Northern Property Taxes

The taxation of the Burlington Northern Railroad's property remained in the spotlight for a good portion of the 1985-86 interim. Following a divisive, partisan political debate during the 49th Legislative Session, and an equally controversial outcome -- the adoption of House Bill No. 240 -- the 49th Legislature again faced the issue of BN's taxes during the second special session and again in the third special session.

At the core of the issue was the appropriate level of property tax for the BN railroad; subordinate to the central issue were questions of how to achieve the appropriate level of tax.

The outcome of the process established the tax rate applicable to the BN at the same level as other utilities, i.e. 12% of market value. The 12% rate was not only congruous with other utilities, it was, arguably, also within the limitations established by the federal government in the Railroad Revitalization and Regulatory Reform Act of 1976, or 4-R Act.<sup>1</sup>

As the 50th Legislative Session approached convention, the BN exercised its legal rights by first, appealing its assessment under the laws of Montana, and later, by

---

<sup>1</sup> The arguments about the legality of the HB 240 provisions, and later the amended version of the law, centered on the inclusion of Montana's net proceeds and gross proceeds taxes on various types of mines. Proponents of the measure contended that the proceeds taxes were both property taxes and property taxes on commercial property, therefore meeting the "all other commercial and industrial" property language of the 4-R Act. Opponents to the measure countered that proceeds taxes are not property taxes, and as such, should not be considered when determining the maximum tax rate. Arguments from both quarters can be found in the minutes of the Senate and House Taxation Committees of the 1985 (49th) legislative session, and in the December 1984 final report of the Revenue Oversight Committee, Montana's Property Tax and the 4-R Act and other Revenue Oversight Issues, Montana Legislative Council, Helena, MT, 1984.

protesting its taxes. The railroad also filed suit in federal district court for protection under the provisions of the 4-R Act.

By the time the 50th Legislature convened in January of 1987, the BN had received temporary federal court protection from the imposition of Montana's property taxes. According to Department of Revenue officials, the case should be concluded prior to the opening of 51st Legislature in 1989.

### Montana's Liquor Enterprise

Contributory to the state's fiscal woes in 1986 was the situation with the state's liquor enterprise. As a "control" state, Montana maintains monopoly control over the sale of alcoholic beverages through licensure of retailers, wholesalers, caterers, and so forth. As part of the liquor enterprise, the state not only taxes liquor and other spiritous beverages, but also generates a profit from the sale of the same beverages.

Paralleling a nationwide trend, Montana experienced (and continues to experience) a decline in the unit volume of liquor sales. The decline translated into less revenue for the state and for local jurisdictions as well.

In an attempt to reverse the revenue decline, the Revenue Oversight Committee worked diligently with the Department of Revenue in developing a recovery plan. After many hours of discussion, debate, and revision, the Revenue Oversight Committee recommended to the full legislature (meeting in special session) that liquor prices be restructured and that the system of state liquor stores and liquor agencies be overhauled.

After some debate in both houses of the legislature, the Revenue Oversight Committee's recommendations were adopted in House Bill No. 30, Special Laws of Montana, 1986, (June).

### In-kind Payment of Property Taxes

Montana has a colorful past, complete with celebrities, politicians, outlaws, and folk heroes. From the earliest days of statehood, Montana's Legislatures have attempted to preserve that heritage through the establishment of the Montana Historical Society, the purchase of unique works of art, and the dedication of a portion of the coal severance tax proceeds to "cultural and aesthetic" purposes.

Following that tradition, Montana's 49th Legislature adopted House Bill No. 701 (Ch. 736, L. 1985), that, under certain conditions, allowed for the "in-kind" payment of inheritance and estate taxes. The in-kind payment was required to be property--personal or real -- of a unique historical or cultural nature.

The purpose of the bill was clearly the preservation of the Daly Mansion near Hamilton, Montana. Due to constitutional restrictions, however, the legislation was drafted broadly enough to allow other estates the option of making in-kind payments, as well. One such estate did avail itself of the option, the Moss (Mansion) estate in Billings, Montana.

Acceptance of in-kind payment required the approval of the legislature. For the Daly Mansion, approval was provided in section 7 of the bill. The Moss Mansion, however, had to follow the strenuous review process outlined in the bill. Nevertheless, both the Daly Mansion and the Moss Mansion met the requirements of the bill including approval of the legislature. The Daly Mansion was accepted by the Department of Revenue as in-kind payment of inheritance and estate taxes in 1986; the department expects acceptance of the Moss Mansion in mid-1987.

### **OTHER ISSUES**

#### Gasohol

Montana's alcohol production tax incentive was an agenda item at a number of Revenue Oversight Committee meetings during the 1985-86 interim. After careful consideration and review, the Committee consciously made no recommendation to

revise the incentive. Adherence to the adage, "If its not busted, don't fix it", was the Committee's response to the issue.

### Vehicle Fees

In 1981, the licensure of light vehicles was revised from an ad valorem tax on the vehicle to a fee system based on the age and weight of the vehicle. As part of the revisions, an inflation factor, "the implicit price deflator for personal consumption expenditures", was written into the formula for determining the appropriate license fee.

During the 1985 session, two additional fees were attached to vehicle licensure: a fee for funding district courts, and a different fees for funding the state's local government block grant program.

In adopting the two fees in Senate Bill No. 142 and House Bill No. 870, respectively, the inflation factor was inadvertently repealed. Consequently, local governments and especially school districts stood to lose an estimated \$9.4 million over the 1985-86 interim.

In light of the problem, the Revenue Oversight Committee reviewed the problem, developed a proposal for solving the problem, and recommended convening a 1-day special session to solve the problem. Somewhat incredibly, the legislature did meet in a 1-day special session in June of 1985, and adopted Senate Bill No. 1, (Ch. 1, Special Laws of 1985, (June)). As adopted, SB 1 reinstated the inflation adjustment just prior to the beginning of the 1986 fiscal year, almost precisely in the form recommended by the Revenue Oversight Committee.

### Property Tax Delinquencies, Tax Sales, and Tax Deeds

Prior to 1987, Montana had for the preceding 100 years had procedures for the payment of property taxes and the sale of property on which the taxes were delinquent. For many reasons the system became antiquated, inefficient, and unworkable.

In response to the situation, the Revenue Oversight Committee worked with local government officials and taxpayer representatives to revise the procedures for tax delinquencies, tax deeds, and tax sales. The result of the Committee's work was manifested in Senate Bill No. 162 introduced during the 1987 session.

For the interested reader, a complete account of the Committee's activity relating to the development of SB 162 can be found in another Revenue Oversight Committee final report, Property Tax Delinquencies, Tax Sales, and Tax Deeds.

### Comprehensive Tax Study

During the later half of the interim, the Committee was acutely aware of efforts by the Congress and the president to reform the federal income tax, and efforts by legislators and the governor to restructure Montana's tax system.

In an attempt to get a head start on the issues surrounding tax reform, House Speaker John Vincent approached the Committee in May of 1986 requesting the Committee to undertake "an all-inclusive, comprehensive tax study to include taxes currently assessed as well as taxes not now utilized".<sup>2</sup> After considerable discussion about the request, the Committee instructed its staff to develop a study plan and attendant cost estimates for completing the study.

At its June 16, 1986 meeting, the Committee agreed to request an appropriation for the purpose of conducting a comprehensive tax study. The scope of the study was eventually limited to analyzing the effects of federal income tax reform on Montanans, and the implications of a statewide, general retail sales tax. The Committee's activities associated with the study are fully discussed in a third final report of the Committee, Federal Tax Reform and A Retail Sales Tax, published by the Montana Legislative Council.

---

<sup>2</sup> Minutes, Revenue Oversight Committee, May 9, 1986, Montana Legislative Council, Helena, MT, p. 4.

### Miscellaneous

The Committee also addressed the usual panoply of issues during the interim. Department litigation, taxpayer complaints, State Tax Appeal Board rulings, the promulgation of rules, and the like appeared from time to time on the Committee's agendas.

While the Committee functioned much as it had during past interims, i.e. it addressed its interim study responsibilities as well its statutory duties, there remained one area wherein the Committee could have devoted more attention: oversight of the Department of Revenue. As required by section 5-18-107, MCA, the Committee is required to exercise oversight over the Department in reviewing proposed budgets, proposed legislation, pending litigation, and major contracts and personnel actions of the Department.

The reasons for lack of concerted oversight were many, but can be attributed primarily to the limitations of staff resources, budget constraints, and time constraints on individual Committee members. With additional staff assigned to the Committee for the 1987-88 interim, it is possible, if not likely, that the true "oversight" function of the Committee would be enhanced.

we/7202f





150 copies of this public document were published at an estimated cost of \$6.33 per copy, for a total cost of \$950.00, which includes \$950.00 for printing and \$.00 for distribution.